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ANTITRUST POLICY AND COMPETITION

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CONTENTS

WITNESSES AND STATEMENTS

MONDAY, NOVEMBER 14, 1983

	Page
Lungren, Hon. Dan, member of the Joint Economic Committee, presiding: Opening statement	1
Miller, Hon. James C., III, Chairman, Federal Trade Commission	2
Armentano, Dominick T., professor of economics, University of Hartford	19
Martin, Donald L., vice president, Glassman-Oliver Economic Consultants, Inc.	34
DiLorenzo, Thomas J., professor of economics, George Mason University	48

SUBMISSIONS FOR THE RECORD

MONDAY, NOVEMBER 14, 1983

Armentano, Dominick T.: Prepared statement	23
Council for a Competitive Economy: Article entitled "Why Not Abolish Antitrust"	63
Martin, Donald L.: Prepared statement	36
Miller, Hon. James C., III: Prepared statement	7

ANTITRUST POLICY AND COMPETITION

MONDAY, NOVEMBER 14, 1983

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to notice, at 10 a.m., in room 2318, Rayburn House Office Building, Hon. Dan Lungren (member of the committee) presiding.

Present: Representative Lungren.

Also present: Charles H. Bradford, assistant director; and William R. Buechner and Christopher J. Frenze, professional staff members.

OPENING STATEMENT OF REPRESENTATIVE LUNGREN, PRESIDING

Representative LUNGREN. It gives me great pleasure to welcome our distinguished witnesses this morning. Since I am also a member of the Subcommittee on Monopolies of the House Judiciary Committee, I am delighted to chair this hearing on antitrust policy and competition.

I might just say as part of background that we have been holding a series of hearings on something that is grandly known as national industrial policy, trying to find out exactly what that means, if it means anything.

At least one of the things that we have come to realize is that antitrust policy is something that needs to be reviewed constantly, but particularly at this time by the Congress. One of the concerns I and some other Members have is that oftentimes we have started to talk about antitrust policy in terms of specifics without taking a look at the generality of antitrust policy and what in fact are to be the guiding principles of antitrust policy.

The specter of increasing monopolization of U.S. industry has been a recurring theme in some congressional and public discussion of industrial organization. Innumerable speeches, hearings, and pieces of legislation have been motivated by the fear of growing industrial concentration and, as a result, many proposals have been advanced in this Congress and in some Federal agencies to deter mergers or break up corporations allegedly wielding excessive monopoly power.

However, it is not altogether clear to me and others whether or not the level of industrial concentration has significantly increased in recent decades. There are a number of classification and measurement problems regarding concentration ratios that make it difficult to say whether concentration or competition has significantly changed over the years. And even if concentration has increased, the response of Government policy depends on the assumptions made about the relationship between concentration and market power.

The issue of antitrust enforcement should arise primarily, in my judgment, when businesses engage in collusive or anticompetitive behavior. In my view the ultimate concern of antitrust policy should be consumer welfare.

As we all know, U.S. businesses must now compete in an increasingly international economic system. Improving the international competitiveness of American industry requires that public policy promote business efficiency, innovation, and cost reduction wherever possible. The antitrust policies of foreign nations have long recognized that increased efficiency and economies of scale confer significant benefits to national trade. The United States must, and I believe has incorporated these considerations into its policy.

Over the last decade, an evolution of antitrust theory and policy has occurred, and progressively more emphasis has been put on efficiency and economies of scale and perhaps less on rigid structural criteria in antitrust analysis.

Certainly other components of Federal economic policy are extremely important. Increasing the rates of savings and capital formation, for instance, has assumed a high priority in the policy of the current administration. Tax and regulatory changes are already in place to remedy these and other economic problems. However, despite this progress, much remains to be done in these and other areas.

So while the more flexible antitrust policy that has emerged in recent years will not solve all of our problems, it can, in conjunction with other elements of economic policy, contribute to an improved economic climate in the years ahead.

I would also like to mention that in some of our hearings we have discussed the Japanese model and the Japanese challenge in international trade. Although these discussions have prompted suggestions that we might make some changes in antitrust policy, it seems to me particularly important that we understand what our own antitrust policy heritage is and then make whatever changes are necessary, as opposed to blindly following what some other country may have done or what we think it may have done.

With those opening comments, I would first like to welcome Mr. James C. Miller III, Chairman of the Federal Trade Commission, and first say that we are happy to have you here, and second, that your prepared statement will be made a part of the record and you may proceed as you wish.

STATEMENT OF HON. JAMES C. MILLER III, CHAIRMAN, FEDERAL TRADE COMMISSION

Mr. MILLER. Thank you, Congressman. I am truly honored to have this opportunity to share views on the nature of our antitrust laws and competition policy.

Let me start with a simple proposition—first articulated by Adam Smith in 1776—namely, that monopoly is the enemy of good management. The obverse of monopoly—that is, competition—causes managers to limit waste, for with competition, only the efficient survive.

Monopoly also misallocates resources. As is well known, too few resources are allocated to monopolistic industries because production and consumption both are limited. In a monopolistic industry, the marginal value of production exceeds marginal cost.

In cases where monopoly power is obtained and/or maintained only by expending resources, the economic cost is even greater. Lobbying to obtain protection from foreign competition is a waste of resources from a societal point of view. So are resources spent in preventing loss of monopolistic rights, such as broadcast licenses and trucking permits, as well as efforts to keep competitors from entering. For example, keeping down the number of nearby broadcast stations and limiting the number of competing truckers.

There are equity concerns over monopoly as well. Consumers are captives and pay higher prices than they would if competition reigned. Potential competitors are kept out of the market. And the purveyor of all this, the monopoly itself, earns a return exceeding that which is necessary.

Our Founding Fathers worried about monopoly and recognized the most pernicious form is that permitted and enforced by Government. Accordingly, they included the commerce clause in our Constitution, essentially prohibiting governmental restraints on the free flow of trade among States.

Likewise, our common law tradition, inherited from the British, was based on a strong hostility to private restraints of trade. This principle was later embodied in the Sherman Act of 1890 and then the FTC and Clayton Acts of 1914.

Since the establishment of our antitrust charters, there has been gradual evolution in their application. As the quality of our analysis of competition and monopolistic conduct has improved over the years, so has the quality of court decisions and enforcement policy. The antitrust policies of the current administration are not, therefore, a revolutionary break from the past, but rather a further step in an evolutionary trend.

It is not my purpose here today to judge court decisions and enforcement policies of the past by the standards of modern legal and economic analysis. Rather, I want to show how the courts and agencies over the years have altered their policies when confronted with new facts and analyses and how our current approach carries on that tradition.

For example. in 1911, the Supreme Court ordered the divestiture of Standard Oil under the antimonopolization provision, section 2, of the Sherman Act. A number of commentators, with the benefit of hindsight and improved economic analysis, have concluded there was no showing of harm to competition or to consumers. At that time, Standard Oil had 147 competitors in the refinery business and the price of the major petroleum product, kerosene, had fallen some 88 percent over the previous half century.

And in 1945, the Second Circuit found Alcoa guilty of monopolization of the sale of primary aluminum ingots apparently because, in Richard Posner's words:

> It had tried to satisfy as much of the growth in demand for aluminum as possible by expanding its own capacity instead of sitting back and letting its competitors or new entrants provide for the growth of the market.

Now, this is scarcely a result that enhances efficiency or serves consumers.

But by 1980, under a previous administration, a unanimous Federal Trade Commission had found DuPont innocent of monopolization

charges in an industry with a four-firm concentration ratio exceeding 0.8. It is instructive to note the Commissioners' reasoning:

> The essence of the competitive process is to induce firms to become more efficient and to pass the benefits of the efficiency on to consumers. That process would be ill-served by using antitrust to block hard, aggressive competition that is solidly based on efficiency and growth opportunities.

Another area currently in flux is the treatment of vertical restraints. In 1967 the Supreme Court held Schwinn guilty of a per se violation of the Sherman Act for imposing a vertical nonprice restraint on its resellers, for insisting on customer and territorial restrictions in the sale of Schwinn bicycles. Ten years later the Court reversed *Schwinn* in the *Sylvania* case, declaring that all vertical nonprice restraints should henceforth be judged under a rule of reason test.

Like that of the Commission in *DuPont*, the Supreme Court's reasoning in *Sylvania* says a lot about the development of antitrust policy over the years. There the Court recognized that "vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his or her products."

They noted further that:

> Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers.

I submit the same reasoning followed by the Court in *Sylvania* would lead it to conclude that vertical price arrangements should also be judged under a rule of reason test.

Evolutionary pressures have also been evident in the analysis of concentration, the question that you raised, Congressman, in your opening statement. In the early 1960's, the Federal Trade Commission, which had been created by Congress in part to incorporate sound economic thinking into antitrust policies, was stating that the very creation of efficiencies that harmed rivals should be grounds for challenging the merger.

In 1966 the Supreme Court found Von's Grocery in violation of section 7 of the Clayton Act without any showing that its acquisition would lead to an output restriction or a price increase. In that case the government had indeed argued the merger would lead to higher consumer prices. But the Court found a violation on the basis that the merger would lead to lower prices, prices that would harm existing competitors. This decision, running directly counter to the Court's 1962 holding in *Brown Shoe* that the antitrust laws were supposed to promote competition, not protect competitors, reflects the uncertainty that existed about how mergers should be analyzed. No wonder Justice Stewart was moved in his dissent to complain that in Clayton section 7 cases only one thing was certain—the Government always wins.

But legal policy evolved. In 1968, the Department of Justice issued a set of guidelines which allowed for the use of additional considerations beyond market shares in deciding whether to challenge a merger. Although the FTC did not issue its own statement, it tended to follow those guidelines as well.

Then in 1974 the Supreme Court in *General Dynamics*, a decision authored by Justice Stewart, upheld a merger in which the two leading coal producers would increase their share of sales from 44 to 53 percent.

Citing *Brown Shoe*, they noted that while evidence on market share is the starting point for judging the anticompetitive effects of a merger, only a further examination of the particular market would enable a determination of its legality.

Likewise, the Commission's treatment of concentrated industries in the 1970's is part of the evolutionary history of antitrust policy. The key cases at the Commission, *Exxon* and *Kellogg*, were both based on structural theories. At the same time a truly massive amount of research questioned the basic premise of the market concentration remedy—that breaking up an industry would lead to lower prices and increased output.

Largely as a result of that research, some of which was performed by economists at the Federal Trade Commission, the fundamental basis for the large structural cases was called into serious question. There arose much concern that divestiture might actually make the affected industries less efficient and, incidentally, make many of them less able to compete in increasingly competitive international markets.

To make a long story short, prior to my tenure the *Exxon* complaint was dismissed by a unanimous Commission and the administrative law judge found no violation in the *Kellogg* case. After my arrival, the Commission dismissed *Kellogg* with prejudice.

Since you asked me to comment on my view of the meaning of competitive markets, let me say that the new approach isn't really all that novel. It goes back to Adam Smith's notion of competition as a dynamic process and monopoly as consisting of artificial restraints on that process; it rejects the static view underlying the market concentration hypothesis; it holds no favor with the notion that markets work best where advertising and other nonprice forms of competition are absent, where products are identical, and where the number of firms must be large. It rejects that approach because it leads to a result which is itself the antithesis of healthy competition.

In the dynamic view to which I subscribe, the competitiveness of an industry is not very well revealed by strict adherence to the conventional structure-conduct-performance paradigm. Frankly, like an increasing number of economists, perhaps even a majority, I look to evidence of restraints on competition and view institutional arrangements within the context of the latest and most persuasive theory and evidence.

In closing let me make a few comments about the Commission's efforts to improve antitrust policy and make our enforcement work more effectively, particularly in the area of mergers.

As you may know, over a year ago, simultaneously with the Justice Department's issuing a new set of merger guidelines, we adopted a new set of principles to govern merger reviews. As our statement makes clear, before deciding to challenge a merger we will consider the Department's concentration guidelines. But, like the Department, we will consider many more aspects of the transaction. We will define markets appropriately, to include foreign production where this is warranted. We will look to amend and supply elasticities and to underlying conditions in formulating our decisions.

From October 1980 to July 1983 we reviewed 3,479 merger filings, representing nearly 2,000 transactions. We issued 56 second requests and three complaints, authorized three others and accepted five con-

sent agreements. And I am convinced that in almost every case, and all of those in which I concurred, we fulfilled our mandate under the Clayton Act to restrain only those arrangements which we had reason to believe would substantially lessen competition or tend to create a monopoly.

I am also very proud of the renewed vigor with which the Commission is addressing the vast collection of Government policies which restrain business rivalry. As I said in my annual address to the antitrust section of the American Bar Association last spring:

> [A] welter of federal, state, and local statutes exempt special interests from the rules that apply to everyone else. National policies shield domestic industries from the rigors of international competition. Purveyors of still other special dispensations, including new antitrust exemptions, broader import protection, centrally managed capital allocation schemes, and programs to revive mature industries and stimulate emerging growth sectors seek approval by government, the press, and other national institutions.

Such is not a harmless prospect. Under the National Recovery Administration in the 1930's, the Federal Government relaxed antitrust enforcement, fostered business/government coordination, and developed codes of so-called ethical business behavior. Rather than expand industrial output, the short-lived NRA's major effects were to make the affected industries less competitive.

We cannot take it for granted that those who seek exemptions from the creative destruction caused by truly open and dynamic markets will not ultimately succeed. In that regard, we are proud to serve in the best tradition of the Commission, which has long opposed such threats to the competitive fabric of our industrial democracy. Here too, we have significantly improved the effectiveness of antitrust policy as we have expanded our scrutiny of governmental restraints on the increasingly important service sector of the economy.

In sum, I believe that under the Reagan administration, as one commentator recently put it, "[A]ntitrust didn't die at all, it just grew up."

Congressman Lungren and members of the committee, that completes my statement. I will be happy to address any questions you might have.

[The prepared statement of Mr. Miller follows:]

PREPARED STATEMENT OF HON. JAMES C. MILLER III*

Mr. Chairman and Members of the Joint Economic Committee: I am truly honored by this opportunity to share views on the proper role of antitrust policy in our economy.

Let me start with a simple proposition -- first articulated by Adam Smith in 1776 -- namely, that monopoly is the enemy of good management. The obverse of monopoly -- competition -- causes managers to limit waste, for with competition only the efficient survive.

Monopoly also misallocates resources. As is well known, too few resources are allocated to monopolistic industries, because production and consumption both are limited. In a monopolistic industry, the marginal value of production exceeds marginal cost.

In cases where monopoly power is obtained and/or maintained only by expending resources, the economic cost is even greater. Lobbying to obtain protection from foreign competition is a waste of resources from a societal point of view. So are resources spent in preventing loss of monopolistic rights (such as broadcast licenses and trucking permits), as well as efforts to keep competitors from entering in (for

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* The views expressed are those of Chairman Miller. They do not necessarily reflect the views of the other Commissioners.

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There are equity concerns over monopoly as well. Consumers are "captives" and pay higher prices than they would if competition reigned. Potential competitors are kept out of the market. And, the purveyor of all this -- the monopoly itself -- earns a return exceeding that which is necessary.

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the major petroleum product, kerosene, had fallen some 88 percent over the previous half-century.[1] And in 1945, the Second Circuit found Alcoa guilty of monopolization of the sale of primary aluminum ingots apparently because, in Richard Posner's words:

> "[I]t had tried to satisfy as much of the growth in demand for aluminum as possible by expanding its own capacity, instead of sitting back and letting its competitors, or new entrants provide for the growth of the market."[2]

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> [T]he essence of the competitive process is to induce firms to become more efficient and to pass the benefits of the efficiency on to consumers. That process would be ill-served by using antitrust to block hard, aggressive competition that is solidly based on efficiency and growth opportunities . . .[3]

Another area currently in flux is the treatment of vertical restraints. In 1967, the Supreme Court held Schwinn guilty of a per se violation of the Sherman Act for imposing a vertical non-price restraint on its

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[1] See, for example, D.T. Armentano, "Antitrust Policy: Reform or Repeal?" Cato Institute, January 18, 1983, p. 3; also see John McGee, "Predatory Price Cutting: The Standard Oil (N.J.) Case," Journal of Law and Economics (October 1958), pp. 137-69.

[2] Richard Posner, Antitrust Law (Chicago: University of Chicago Press, 1976), p. 214.

[3] E.I. du Pont de Nemours & Co., 96 F.T.C., 653 at 750-51 (1980).

resellers -- for insisting on customer and territorial restrictions in the sale of Schwinn bicycles. Ten years later the Court reversed Schwinn in the Sylvania case, declaring that all vertical non-price restraints should, henceforth, be judged under a "rule of reason" test.

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> Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his [or her] products.[4]

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4 GTE-Sylvania, 433 U.S. 36, at 54.

5 Ibid, pp. 54-55.

government had, indeed, argued the merger would lead to higher consumer prices. But the Court found a violation on the basis that the merger would lead to lower prices -- prices that would harm existing competitors. This decision, running directly counter to the Court's 1962 holding in Brown Shoe that the antitrust laws were supposed to promote competition, not protect competitors, reflects the uncertainty that existed about how mergers should be analyzed. No wonder Justice Stewart was moved in his dissent to complain that in Clayton Section 7 cases only one thing was certain: the government always wins!

But legal policy evolved. In 1968 the Department of Justice issued a set of guidelines which allowed for the use of additional considerations -- beyond market shares -- in deciding whether to challenge mergers.[6] (Although the FTC did not issue its own statement, it tended to follow those guidelines as well.) Then, in 1974, the Supreme Court in General Dynamics -- a decision authored by Justice Stewart -- upheld a merger in which the two leading coal producers would increase their share of sales from 44 percent to 53 percent. Citing Brown Shoe, they noted that while evidence on market share is the starting point for judging the anticompetitive effects of a merger, "only a further examination of the particular market" could enable a determination of its legality.[7]

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[6] Department of Justice, Merger Guidelines (May 30, 1968).

[7] 415 U.S. 486, 498 (1974), quoting Brown Shoe, 370 U.S. at 322 n.38.

Largely as a result of that research -- some of which was performed by economists at the Commission[8] -- the fundamental basis for the large structural cases was called into serious question. There arose much concern that divestiture might actually make the affected industries less efficient and, incidentally, make many of them less able to compete in the increasingly competitive international markets.

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In closing, let me make a few comments about the Commission's efforts to improve antitrust policy and make our enforcement work more effective, particularly in the area of mergers.

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[8] See, for example, John Kwoka, "The Effect of Market Share Distribution on Industry Performance," Review of Economics and Statistics (February 1979), pp. 101-109.

As you may know, over a year ago, simultaneously with the Justice Department's issuing a new set of merger guidelines,[9] we adopted a new set of principles to govern merger reviews.[10] As our statement makes clear, before deciding to challenge a merger we will consider the Department's concentration guidelines. But, like the Department, we will consider many more aspects of the transaction. We will define markets appropriately, to include foreign production where this is warranted. We will look to demand and supply elasticities, and to underlying conditions, in formulating our decisions.

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9 Department of Justice, Merger Guidelines (June 14, 1982).

10 Federal Trade Commission, Policy Statement on Horizontal Mergers (June 14, 1982).

> stimulate emerging growth sectors -- seek approval by government, the press, and other national institutions.[11]

Such is not a harmless prospect. Under the National Recovery Administration (NRA) in the 1930's, the Federal government relaxed antitrust enforcement, fostered business/government coordination, and developed codes of so-called "ethical" business behavior. Rather than expand industrial output, the short-lived NRA's major effects were to make the affected industries less competitive.

We cannot take it for granted that those who seek exemptions from the "creative destruction" caused by truly open and dynamic markets will not ultimately succeed. And in that regard we are proud to serve in the best tradition of the Commission, which has long opposed such threats to the competitive fabric of our industrial democracy. Here, too, we have significantly improved the effectiveness of antitrust policy as we have expanded our scrutiny of governmental restraints in the increasingly important service sector of the economy.

In sum, I believe that under the Reagan Administration, as one commentator recently put it: "[A]ntitrust didn't die at all -- it just grew up."[12]

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Mr. Chairman and Members of the Committee: that completes my prepared statement. I shall be happy to address to any questions you might have.

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[11] Remarks of James C. Miller III before the Annual Spring Meeting of the American Bar Association Section of Antitrust Law (March 25, 1983), p. 2.

[12] Joe Sims, "Antitrust Reenters the Spotlight at the Supreme Court," Legal Times (November 3, 1983), p. 16.

Representative LUNGREN. Thank you very much, Chairman Miller.

In an article that appeared in the Washington Post on October 9 of this year Robert Samuelson, in describing the change that is taking place with respect to interpretation of antitrust law, said:

> What is going on, Adam Smith is not being rejected but reread. What ultimately concerned Smith was economic efficiency and the welfare gains it implied for society. Until recently economists mostly accepted Smith's framework—the more competitors, the merrier. All this is changing.

How would you respond to that description of the new analysis of antitrust policy?

Mr. MILLER. I think Samuelson is largely on the mark. After all, it was Smith who said that consumption is the end objective of production. He had in mind the satisfaction of human wants as the raison d'etre of production. I think a close reading of Smith will give you the feeling that he did not necessarily turn to large numbers of firms as a necessary condition for obtaining competition.

Representative LUNGREN. That, however, does seem to be sort of the background of many individuals unschooled in the economic analysis of antitrust policy. It almost seems a statement of faith when you are growing up in this country that the more the merrier, and if you have fewer, that indicates we have less competition. In that regard, can you tell me whether there is any persuasive evidence that industrial concentration has increased significantly in the last two decades, or that competition has declined in that period?

Mr. MILLER. Congressman, let me say first perhaps we economists are somewhat responsible for the shibboleth that you have to have a large number of firms to have competition. After all, in our principles courses we usually teach the theory of competition, and one of our underlying assumptions is that there are a large number of firms, and many of us, I am afraid, do not get past that point in explaining the principles to students. So I think we have some work to do in explaining things a bit better.

On the evidence question, one of the remarkable constants in American industry has been the level of concentration. If you go back and look at the data, whether you measure concentration by sales of all nonfinancial institutions, by manufacturing institutions only, or even by reasonably broad industry categories, you will find that over the decades the level of concentration has remained virtually unchanged. There has been vertical mobility; the identification of the firms at the top and the bottom have changed; but the overall level of concentration has remained virtually unchanged over the period of almost a century.

Obviously the quality of our data gets poorer as we go back in time, but the studies by Professor Nutter and the studies updating his original work show that.

Representative LUNGREN. Some economists in reanalyzing antitrust policy have argued that maintenance of a large market share by a leading firm may in fact suggest superior efficiency. How do you respond to the idea that the market result is evidence of efficiency?

Mr. MILLER. Well, that is what we in economics sometimes call an identification problem. Two hypotheses could possibly explain the evidence that you are looking at. It could well be that the firm has a very large market share because there are restraints on entry or

other restraints on competition and so it fills in where others are not allowed to. On the other hand, it may simply reveal that it is a very efficient firm. So, you have to look at underlying conditions. I think it would be a mistake to make a presumption that this industry is monopolistic or competitive just based on the fact that one firm has a large market share.

Representative LUNGREN. Recently, Lester Thurow has talked about what he calls the failure of antitrust. He has made some suggestions about how we deal with national industrial policy, which I disagree with, but he makes some very interesting points in the book entitled "Zero Sum Society." In the chapter that he entitles "The Future of Antitrust" he has this to say:

> The futility and obsolescence of the antitrust laws can be seen from a number of vantage points. First, with the growth of international trade it is no longer possible to determine whether an effective monopoly exists by looking at local market shares. Regardless of the share of domestic production held by General Motors, General Motors is part of a competitive industry and must deal with strong European and Japanese competitors. In markets where international trade exists, or could exist, national antitrust laws no longer make sense. If they do anything, they only serve to hinder U.S. competitors who must live by a code that their foreign competitors can ignore.

I wonder if you could comment on, first, his assumptions, and then his conclusions.

Mr. MILLER. Let me qualify my statement by emphasizing that I cannot speak to anything having to do with General Motors or Toyota.

Representative LUNGREN. I understand that.

Mr. MILLER. We are reviewing that matter right now.

But let me speak to the generic issue he raises. I think for the application of the antitrust laws to ignore the increasingly competitive world markets is a mistake. On the other hand, I do not believe that the antitrust laws are obsolete for this reason, simply because I think you will see that the Justice Department's guidelines and the principles statement that we issued is a recognition of the importance of international markets and includes them. I mentioned that specifically in my statement. I think the courts also have been going in that direction.

Perhaps if Congress wanted to give some guidance to us in that regard along those lines that would be appropriate, but I would not characterize the antitrust laws as obsolete.

Representative LUNGREN. How important are nongovernmental barriers to entry? Things such as advertising and high capital investment, are they really entry barriers? In contrast, how important are Government-erected barriers to entry?

Mr. MILLER. Congressman, advertising in the history of economic industrial organization literature was first presumed to be an impediment to entry, a barrier to entry. Some of the later literature has indicated that this is not necessarily so; in many cases advertising can be a means of entry.

High capital requirements sometimes do make it more difficult for new firms to enter, depending on the scale of demand. If there are substantial economies for which high capital requirements cannot be amortized, this might be a scale economy. This might be looked on as a barrier to entry. Usually firms already in such markets are amortizing large capital requirements as well. Only if technology changes

in a dramatic way would I see this as constituting some barrier to entry, and even then one would look toward the firms already in the industry as perhaps receiving what commonly is called quasi-rents or maybe even negative quasi-rents in this regard in case the technological change made obsolete the kinds of equipment investments they had already made.

In terms of governmental restraints on trade, as I think I indicated in my statement, they are the most pernicious kind of restraints on trade. If you have an advertising restraint on trade or something else that might restrain entry, people will find a way of getting around it, technology will change, something will happen. If you have a governmental restraint on trade, you have the forces of the public sector down on your back for anyone who tries to circumvent the restraint on the markets.

I think economists are increasingly recognizing that perhaps the best area for academic research and for policy change and perhaps improve the lot of consumers would be to direct their attention to those governmental restraints on competition.

Representative LUNGREN. Would you like to venture an opinion as to how well Congress, at the present time, is responding to the increased appreciation of Government barriers to entry?

Mr. MILLER. There is some good news and there is some bad news. The good news is that Congress made it possible for President Reagan to decontrol oil. That whole energy area was a potpourri of regulatory controls and impediments to competition, and under the President's leadership those have been phased out. The Congress has an opportunity to deregulate natural gas, and I wish it would. The Congress is allowing and encouraging, in the transportation area, deregulation to move forward. On the other hand, there is talk of some increasing pressures for protectionist legislation, and one thing I would single out in particular is the domestic content legislation, which I think would be a very bad idea, and it is a bill, as I recollect, on which a unanimous Commission indicated its concern.

Representative LUNGREN. Frequently, particularly here in the Congress, critics of mergers decry the withdrawal of funds from the economy for what they refer to as unproductive purposes such as financing mergers. Do corporate mergers necessarily consume financial capital, or is this money merely being channeled in a different way?

Mr. MILLER. The answer is obviously the latter, Congressman. To hear some of the critics complain, you would think that the resources disappear off the face of the Earth. They are channeled into other people's pockets and those people do something with those resources.

Representative LUNGREN. Following along on that line, criticism of conglomerate mergers is often intense here on the Hill. I assume from your testimony that you would argue that conglomerate mergers can occur for sound financial reasons, and if so, could you give us some general principles?

Mr. MILLER. I think you are absolutely right in the way you characterize my testimony. Conglomerate mergers can be beneficial to consumers generally and to competition as well. If one firm purchases another firm for a good buy, it is a reflection that the stockholders or the potential buyers place a low premium or that the market places a low

premium on those resources as used by the present management, and a conglomerate merger can many times put them to better use.

Conglomerate mergers have moved in cycles, as you know, and on some occasions people have thought that the benefits of conglomeration would far exceed the costs when they have not. But that is the way the market works. You can have instances where the demands of management might be cyclical and you might pick up a firm in a different line of business where the demands of management are countercyclical. You might have complementarity in the financial structure of two firms as the result of a conglomerate merger.

So there are important efficiency gains that can be had from conglomeration, and just as a general principle conglomerate mergers do not pose problems for reducing competition.

Representative LUNGREN. You mention in your testimony the evolutionary process that is taking place in terms of antitrust policy with respect to what the administration is doing and also with respect to the courts. I take it from your testimony you perceive that to be a continuing evolution and do not see anything on the horizon to suggest a reversal of that trend in the courts.

Mr. MILLER. That is accurate. I think that this evolution will continue. I think the court system weighs things just as carefully, if not more so, than Federal Trade Commissioners. They look at what the Congress has set out as being the standards for judging mergers and other kinds of industrial activity and try to reflect the most recent persuasive thinking about the economic effects and the legal doctrines.

Representative LUNGREN. Chairman Miller, I thank you for appearing today. As I mentioned to you before, this committee is a nonlegislative committee, and therefore we do not necessarily hold hearings with an intent toward coming up with a particular piece of legislation. We try in some ways to be more general and to give some background to all Members of Congress with respect to these issues. So if we have not asked questions on specific pieces of legislation it is intentional. This hearing is an effort on our part to try to reexamine the general principles of antitrust law in the context of the competitive situation of the U.S. economy, vis-a-vis the international marketplace.

I want to thank you.

Mr. MILLER. Thank you, Congressman. Let me say as an economist, it is always a distinct honor to appear before the Joint Economic Committee.

Representative LUNGREN. Thank you very much.

Next we are going to hear from a distinguished panel: Donald Martin, vice president, Glassman-Oliver Economic Consultants, Inc.; Thomas DiLorenzo of George Mason University; and Dominick Armentano of the University of Hartford.

Gentleman, I want to thank you for taking the time to appear before us today.

I noted that all of you were in the room when I mentioned what the purpose of the hearing is, and I would just repeat that we will make your prepared statements part of the record, but you may proceed as you wish.

STATEMENT OF DOMINICK T. ARMENTANO, PROFESSOR OF ECONOMICS, UNIVERSITY OF HARTFORD

Mr. ARMENTANO. I am grateful to have this opportunity to appear before this committee and to discuss antitrust policy.

There are four major sections of my prepared statement. In the first part, I argue that the most effective antimonopoly and procompetition policy that the Government could adopt is not additional antitrust enforcement but accelerated governmental deregulation of business.

In the second part of my prepared statement, I argue that the traditional enforcement of the antitrust laws has not, on balance, promoted competition at all.

The third part of the statement concerns the recent changes in the administration of the antitrust laws and the intellectual justification for those changes.

And finally, I note that in open competition market shares and business concentration simply reflect cost, price, and product efficiencies, and that there is never a good reason to interfere with the competitive process in the name of consumer welfare. If we are going to enforce the antitrust laws at all, let us use the laws against legal barriers to entry.

The sole source of resource misallocating monopoly power is governmental restrictions on entry and competition. Governmental licensing, certificates of public convenience, quotas—both foreign and domestic—franchises, and other legal barriers are the essence of monopoly power.

The most appropriate public policy to combat monopoly is deregulation. To remove legal barriers that restrict competition should be the primary thrust of any rational antimonopoly policy. To remove these barriers would create open markets and open markets are markets within which a competitive process is always present.

Happily, many of these barriers to competition, especially at the Federal level, are being removed rapidly. The essence of deregulation in telecommunications, in transportation, and even in banking is the removal of governmental impediments to entry and price competition. As these legal barriers are removed, entrepreneurs are then free to offer products or services to consumers without governmental interference. This competitive process is inevitable when controls are ended.

The fact that deregulation is often opposed by certain elements in the business community or opposed by certain trade associations or unions, is the strongest possible indication that these policies are correct from a consumer welfare perspective, and that we should continue full steam ahead with these policies.

When markets are deregulated and free, there is a great temptation to argue that we must now apply the antitrust laws in order to preserve competition. This argument is currently being made in the trucking industry that is about to lose its longstanding exemption from the antitrust laws.

Well, I disagree with all of this. From my perspective the competitive process does not need any protecting or preserving with antitrust laws. Indeed, antitrust in my view, both public and private, has had an extremely poor legal history of serving the consumer's interest.

There is precious little in the classic antitrust cases to convince anyone, much less an economist, that monopoly power was or is a free market problem, or that the firms indicted and convicted under the laws were damaging the so-called public interest. The cases often demonstrate that the firms involved were reducing costs and prices and engaging in an intensely competitive process, and the laws, whatever their alleged intent, were employed to restrict and restrain that competitive process. This may sound incredible, even unbelievable, but a close reading of the classic antitrust cases can make a believer out of almost anyone.

In the prepared statement that I submitted to this committee, I reviewed a number of classic monopoly cases, including Standard Oil, American Tobacco, U.S. Steel, and Alcoa. In the book that I wrote, which was published last year, entitled "Antitrust and Monopoly," I review 52 classic cases where I argue that a close reading of the cases would indicate that the antitrust laws were used to restrict and restrain competition and had nothing to do with monopoly whatsoever.

The past irrationalities of traditional antitrust enforcement have not been confined to the classic monopoly cases. Mergers that would have increased efficiency and likely intensified competition have been legally prevented in the name of concern over increasing concentration. Price discrimination, an important element of a rivalrous competitive process, has been vigorously and mistakenly prosecuted by the FTC since the early 1930's. And it is only too clear that in the thousands of private antitrust cases where one corporation sues another, the law serves to restrain and restrict the competitive commerical activities of the defendant corporation. In these latter cases, at least, there is no pretense that the concern is monopoly or that the interest that is being served is the public interest. In the private cases, it is entirely too obvious that antitrust serves to hamper and restrict free market competition.

Within the last 10 years, the widespread support for traditional antitrust enforcement has eroded considerably. There is now an important group of scholars and policy officials that seriously doubt the wisdom of conventional enforcement. Antitrust critics are often associated with the view that much of our traditional enforcement has been misplaced and may have served to restrict competition and not enhance it. The critics would substantially reduce traditional enforcement, and there is abundant evidence that most current policies and enforcement efforts reflect the new directions of the critics.

In the prepared statement that I submitted to this committee, I reviewed a number of recent antitrust actions. These activities or hearing examiner decisions by the FTC, by and large, would indicate that these new antitrust directions are in place in some instances.

The collapse of the intellectual support for traditional antitrust enforcement can be traced to a number of different developments. Most important is the professional disenchantment with the orthodox barriers to entry doctrine. It is now widely admitted that most of these barriers were in reality economies and efficiencies that business organizations had earned in the marketplace. For instance, economies of scale only limit competition with high cost firms, hardly a good reason to prosecute such barriers in the name of consumer welfare.

Product differentiation, another alleged barrier, only limits competition with firms unable to match the products and the experience of the existing firms.

If advertising limits competition, it does so by reducing the cost and price of the product advertised. Advertising expenditures that increase costs and price would hardly act as a barrier to entry but in fact would act as an invitation to entry. In every instance, efficiency broadly conceived, not market power, excluded the less efficient business organization.

Complementary to this theoretical revisionism has been numerous empirical investigations of concentration and high profits. The early work in this area had appeared to discover a slight positive correlation between high concentration and above-normal rates of return. These studies assumed that barriers to entry limited competition in the concentrated industries, and that this restriction explained the persistence of monopoly profits.

Critics of these early studies maintain that persistently high profits can be more easily explained by greater efficiency on the part of the faster growing, high market share companies. Moreover, the critics hold that the positive correlations between concentration and profit tend to disappear with a longer time period under investigation and a larger industry sample size.

Finally, Yale Brozen has argued recently in his book entitled "Concentration, Mergers, and Public Policy" that the weight of the new empirical evidence, the so-called new learning, is now overwhelming, that market share and concentration reflect efficiency and not market power.

This last conclusion is absolutely crucial to an understanding of any rational antitrust policy. Market share and industrial concentration simply reflect price and cost efficiencies and do not evidence any antisocial monopoly power.

Let me say this in an even more controversial way. It ought not to be the business of the antitrust laws to either promote or hinder market share or concentration. If firms earn market share in an open competitive environment, they deserve it. If markets become concentrated over time, this only testifies to the fact that the leading companies are growing faster than their competition, and that can only be accomplished in open markets by superior economic performance. On the other hand, if firms cannot maintain superior economic performance, they will lose market share to other companies.

Parenthetically, there are many examples of this in antitrust history. The *Standard Oil* case, which was mentioned by Chairman Miller, is a good indication of that. Standard Oil dominated the industry in the 19th century and obtained a market share as high as 85 percent; some commentators say 88 percent. But then, 20 years prior to the antitrust case against Standard, its market share declined. It declined roughly from 88 percent in 1885 to 68 percent in 1907 when it was indicted for being a monopoly in restraint of trade. So even the great Standard Oil Co. was not able to maintain its efficiency in the face of competition; it became less efficient relative to other companies; they grew faster than it did, and its market share declined. So when the Government came in and broke up Standard Oil in 1911, its market share was as low as it had been since the turn of the century.

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In either case, whether a firm gains market share or loses it, there is no useful role for antitrust policy. Thus, I oppose any attempt to limit so-called predatory pricing practices or determine the permissible amount of business mergers through either law or administrative guidelines. Such restrictions are not only ambiguous and arbitrary in the extreme, but they are also fundamentally restrictive of an open competitive process.

Let me close my remarks by connecting my criticism of traditional policy with my belief that monopoly power is created by governmental entry restrictions. One useful purpose that could be served by antitrust enforcement would be to have the laws employed against legal monopoly. If we are going to have any antitrust policy at all, and I am not sure that we should have any at all, let us at least use the laws against pernicious legal barriers to entry. This would supplement and support the deregulation movement and move us more quickly in the direction of open and free markets. Thank you very much.

[The prepared statement of Mr. Armentano follows:]

PREPARED STATEMENT OF DOMINICK T. ARMENTANO

Toward A Rational Antitrust Policy

I am grateful to have this opportunity to appear before this Committee and to discuss antitrust policy.

There are four major sections of my paper. In the first part I argue that the most effective anti-monopoly and pro-competition policy that the government could adopt is not additional antitrust enforcement but accelerated governmental deregulation of business. In the second part of my paper I argue that the traditional enforcement of the antitrust laws has not, on balance, promoted competition. The third part of the paper concerns the recent changes in the administration of the antitrust laws and the intellectual justification for those changes. And finally I note that in open competition, market shares and business concentration simply reflect cost, price, and product efficiencies, and that there is never a good reason to interfere with the competitive process in the name of consumer welfare. If we are going to enforce the antitrust laws at all, let's use the laws against legal barriers to entry.

I

The sole source of resource misallocating monopoly power is governmental restrictions on entry and competition. This is the manner in which Adam Smith used the term in The Wealth of Nations and this is still the best and least ambiguous way to use the term today. Government creates monopoly power whenever it legally restricts and restrains entry into markets, or whenever it restricts foreign or domestic competition. Governmental licensing, certificates of public convenience, quotas (both foreign and domestic), franchises,

and other legal barriers are the essence of monopoly power. The firms or individuals protected from competition enjoy the advantages of "monopoly", and the consumers and shut-out suppliers are "injured" by the monopoly.

The most appropriate public policy to combat monopoly is deregulation. To remove legal barriers that restrict competition should be the primary thrust of any rational anti-monopoly policy. To remove these barriers would create open markets and open markets, in my view, are markets within which a competitive process is always present.

Even a cursory historical examination of the American experience would indicate that we have had a good share of legal monopoly in this country, and still do have a good share of it, especially at the state level. Most of this monopoly, historically, was advocated by certain interest groups in business and in the professional area that were anxious to restrict competition when they felt that their own interests would be advanced by such restructions. This process of monopolization was usually whitewashed or covered with "public interest" rhetoric such as a concern for "safety", or eliminating "duplication", or ensuring that consumers received a high quality product or service at a fair price. Yet there are now many scholarly studies that confirm that the movement to monopolize markets by restricting entry had little to do with any legitimate concern for consumer welfare. The actual motivation was to legally restrain commerce, to stabilize industry prices and profits, to preserve existing market shares and, most importantly, to keep new entrepreneurs with new technologies out of those markets. To some extent this monopolization succeeded and we are all slightly poorer for it.

Happily many of these policies -- especially at the federal level -- are

being reversed rapidly. The essence of deregulation in telecommunications, in transportation, and even in banking is the removal of governmental impediments to entry and price competition. As these legal barriers are removed, entrepreneurs are then free to offer products or services to consumers without governmental interference. This competitive process is inevitable when controls are ended. The fact that deregulation is often opposed by certain elements in the business community, or opposed by certain trade associations or unions, is the strongest possible indication that these policies are correct from a consumer-welfare perspective, and that we should continue full steam ahead with these policies.

II.

When markets are deregulated and free there is a great temptation to argue that we must now apply the antitrust laws in order to "preserve competition." This argument is currently being made in the trucking industry that is about to lose its long-standing exemption from the antitrust laws.

Well, I disagree with all of this. From my perspective the competitive process doesn't need any protecting or preserving with antitrust policy. Indeed, antitrust in my view, both public and private, had an extremely poor legal history of serving the consumer's interest. There is precious little in the classic antitrust cases to convince anyone -- much less an economist -- that monopoly power was or is a free-market problem, or that the firms indicted (and convicted) under the laws were damaging the "public interest," The cases most often demonstrate that the firms involved were reducing costs and prices

and engaging in an intensely competitive process, and that the antitrust laws -- whatever their alleged intent -- were employed to restrict and restrain the competitive process. This may sound incredible, even unbelievable, but a close reading of the classic antitrust cases can make a believer out of almost anyone. The cases discussed briefly below are illustrative of the legal history of antitrust.

Standard Oil (1911) For instance, in the classic Standard Oil case (1911), it is still widely believed that Standard of New Jersey was convicted because it had restricted production, raised prices, and engaged in ruthless predatory practices to destroy competition. Yet none of this was ever proven in court. Standard lost the decision in 1911 because a lower court in 1909 had determined that the formation of its holding company in 1899 was prima facie illegal since it ended the potentiality of competition between the (now) merged firms. The Supreme Court, while announcing a rule of reason, simply reaffirmed the unanalytical decision of that lower court.

An objective study of the petroleum industry between 1859 and 1911 would reveal that Standard did not plunder consumers or competitors. The price of kerosene -- the industry's major product -- dropped from over 50 cents a gallon in the early 1860s to less than six cents in the late 1890s. While Standard always did a large share of the industry's business, they always had competition. When they were dissolved in 1911 for monopolizing in restraint of trade, there were at least 147 independent petroleum refining companies selling products in competition with the Standard Oil Company. The industry was not monopolized.

American Tobacco (1911) The American Tobacco Company (the Tobacco Trust) was ordered dissolved by the Supreme Court in 1911. Again, legend has it that American Tobacco ruthlessly raised cigarette prices, drove down the price of leaf tobacco, engaged in "predatory" wars with rivals, and generally acted like the abusive monopoly of antitrust theory.

The legend is sheer fantasy; none of this was ever proven. The Supreme Court did not rule specifically on these charges, and the lower court, which had discussed the charges in some detail, concluded that they did not occur. Even a casual reading of the lower court decision would reveal that the prices of tobacco products were not arbitrarily increased (cigarette prices fell between 1895 and 1907), that leaf tobacco prices rose substantially, and that American Tobacco did not "dragoon" competitors into bankruptcy or merger with itself. There were hundreds of companies selling cigarettes in the market, and many thousands more selling smoking tobacco, plug, snuff, and cigars. The American Tobacco Company was large and had a high percentage share in some tobacco markets, but it had not obtained a coercive monopoly position in the tobacco industry.

U.S. Steel (1920) The United States Steel Company, the largest corporation in the country when it was formed as a holding company in 1901, was indicted by the Department of Justice in 1911. The corporation, however, was found innocent of monopolizing in 1915 and again in 1920. With the Supreme Court's newly enunciated rule of reason actually in effect, U.S. Steel demonstrated to a majority of judges and justices that it did have active competition,

that the competitors were growing faster than the U.S. Steel Company, that essential raw materials were not being monopolized, and that the prices of steel products had fallen on average between 1901 and 1911. Although U.S. Steel admittedly was of impressive size, the Supreme Court declared that "its power over price was not and is not commensurate with its power to produce." Since its economic conduct and performance were judged reasonable, and since mere size was not to be a legal offense, U.S. Steel (and many other large corporations in very similar trials) was declared innocent of any economic wrongdoing.

Alcoa (1945) The 1945 Alcoa decision reversed the rule of reason approach and again made high market share a legal offense. Alcoa was convicted of monopolizing an artificially defined relevant market: primary ingot aluminum. Even though the special Court of Appeals admitted that secondary aluminum (scrap) competed pound for pound with primary ingot, they steadfastly refused to include it when measuring Alcoa's share of the market. Without scrap, Alcoa was doing almost 90 percent of the aluminum ingot business, and that in and of itself was enough to constitute a monopoly and a violation of the law. Alcoa may have been a "good trust," but the Congress had not meant to condone good trusts, said the court in 1945.

Alcoa was, indeed, a good trust, as the lower court decision of 1939 had clearly demonstrated. District Court Judge Caffey had found Alcoa innocent of more than 140 separate government charges. Caffey had laboriously determined that Alcoa had not monopolized bauxite, water power sites, aluminum ingot, castings, pistons, or many other items as the government had charges in its long-

winded indictment. In addition, Alcoa had not illegally excluded competition, engaged in conspiracy, and charged "exorbitant" prices, or earned an "exorbitant" rate of return. Aluminum ingot prices had fallen from over $2.00 a pound in the 1890s to less than 22 cents a pound at the time of the trial, and Alcoa's average rate of return for 50 years was just over 10 percent on invested capital. Yet all of this was suddenly irrelevant in 1945. To maintain a high market share for a long period of time -- an extraordinary business achievement -- was to monopolize in violation of the antiturst law.

Actually Alcoa's efficient performance was legally worse than irrelevant and immaterial; it helped convict the company. Circuit Court Judge Learned Hand explained that it was Alcoa's "skill, energy, and initiative" that "excluded" competitors in aluminum production. If Alcoa had been less efficient there would have been "more competition" and no violation of the antiturst law. In one of the most outrageous statements in antitrust history, Alcoa's industrial virtures were condemned as an illegal restraint of trade.

> It was not inevitable that it (Alcoa) should always anticipate increases in the demand for ingot and be prepared to supply them. Nothing compelled it to keep doubling and redoubling its capacity before others entered the field. It insists that it never excluded competitors; but we can think of no more effective exclusion than progressively to embrace each new opportunity as it opened, and to face every newcomer with new capacity already geared into a great organization, having the advantage of experience, trade connections and the elite of personnel.

The past irrationalities of antitrust enforcement have not been confined to the classic monopoly cases. Business mergers that would have increased efficiency and likely intensified competition have been legally prevented in the name of a concern over increasing "concentration." Price discrimination, an important element of a rivalrous competitive process, has been vigorously and mistakenly

prosecuted by the Federal Trade Commission since the early 1930s. And it is only too clear that in the thousands of private antitrust cases (where one corporation sues another), the law serves to restrain and restrict the competitive commercial activities of the defendant corporation. In these latter cases, at least, there is no pretense that the concern is "monopoly," or that the interest that is being served is the public interest. In the private cases it is entirely too obvious that antitrust serves to hamper and restrict free market competition.

III.

Within the last 10 years the widespread support for traditional antitrust enforcement has eroded considerably. There is now an important group of scholars and policy officials that seriously doubt the wisdom of conventional enforcement. Antitrust critics are often associated with the view that much of our traditional enforcement has been misplaced and may have served to restrict competition and not enhance it. The critics would substantially reduce traditional enforcement efforts, and there is abundant evidence that most current policies and enforcement efforts reflect the "new directions" of the critics.

It is clear that the abandonment by the Justice Department and Federal Trade Commission of landmark antitrust cases against IBM and the leading ready-to-eat cereal companies is entirely appropriate from the perspective of the antitrust critics. IBM was not a monopoly when the Department of Justice brought its antitrust suit in 1969, and it is certainly not a monopoly today. Likewise, the cereal industry personifies a condition of rivalrous competition, and the leading companies never "shared a monopoly" as the Federal Trade Commission had

boldly asserted. Both of these cases were premised on the misguided notion that efficiency ought to be attacked since it is exclusionary of potential competitors and results in substantial market share. Yet the defendants in these cases had earned their shares (and expanded them) through a rigorous competitive performance. Occasionally, smaller competitors found such a rigorous competitive process difficult. But why should the antitrust laws protect less efficient competitors (or potential competitors) from the rigors of open competition? Almost 20 years of litigation was wasted on these silly cases.

The collapse of the intellectual support for traditional antitrust enforcement can be traced to a number of different developments. Most important is the disenchantment with the orthodox "barriers to entry" doctrine. It is now widely admitted that most of these so-called barriers were in reality economies and efficiencies that business organizations had earned in the marketplace. Economies of scale only "limited competition" with high-cost firms -- hardly a good reason to prosecute such barriers in the name of consumer welfare. Product differentiation only limited competition with firms unable to match the products and the experience of the existing firms. If advertising limited competition, it did so by reducing the cost and price of the product advertised. Advertising expenditures that increased costs and price would act as an invitation to entry and not as a barrier. In every instance efficiency broadly conceived, not market power, excluded the less efficient business organization.

Complementary to this theoretical revisionism have been numerous empirical investigations of the collusion/concentration/high profits hypothesis. The early work in this area had appeared to discover a slight positive correlation between high concentration and above-normal rates of return. These studies

assumed that barriers to entry limited competition in the concentrated industries, and that this restriction explained the persistence of monopoly profits. Critics of these early studies maintain, however, that persistently high profits can be more easily explained by greater efficiency on the part of the faster growing, high-market-share companies. Moreover, the critics hold that the positive correlations between concentration and profit disappear with a longer time period under investigation and a larger industry sample size. Finally, Yale Brozen has argued recently (Concentration, Mergers, and Public Policy, MacMillan 1982)) that the weight of the new empirical evidence is now overwhelming that market share and concentration reflect efficiency and not monopoly power.

IV.

This last conclusion is absolutely crucial to an understanding of any rational antitrust policy. Market share and industrial concentration simply reflect price and cost efficiencies and do not evidence any antisocial monopoly power. Let me say this in an even more controversial way: It ought not to be the business of the antitrust laws to either promote or hinder market share or concentration. If firms earn market share in an open competitive environment, they deserve it. If markets become concentrated over time this only testifies to the fact that the leading companies are growing faster than their competition, and that can only be accomplished -- in open markets -- by superior economic performance. On the other hand, if firms cannot maintain superior economic performance they will lose market share to other companies. In either case there is no useful role for antitrust policy. Thus I oppose any attempt to

limit so-called predatory pricing practices or determine the permissable amount of business mergers through either law or administrative guidelines. Such restrictions are not only ambiguous and arbitrary in the extreme, but they are also fundamentally restrictive of an open competitive process.

The most obvious example of this anti-competitive effect is the legal limitation on mergers in already "concentrated" markets. In the beer industry, for instance, Anheuser Busch and Miller Brewing -- the dominant beer companies -- can now breath easier knowing that the government will apparently prevent consolidations large enough to threaten their market position. In this instance the merger guidelines serve not to protect consumers from monopoly but to protect some firms from the competition of other firms. That, unfortunately, is entirely too typical of much of antitrust enforcement.

Let me close my remarks by connecting my criticism of traditional antitrust policy with my belief that monopoly power is created by governmental entry restrictions. One useful purpose that could be served by antitrust enforcement would be to have the laws employed against legal monopoly. If we are going to have any antitrust policy at all -- and I am not sure that we should have any at all -- let's at least use the laws against pernicious legal barriers to entry. This would supplement and support the deregulation movement and move us more quickly in the direction of open and free markets.

Thank you.

Representative LUNGREN. Next we will hear from Donald Martin, vice president of Glassman-Oliver Economic Consultants, Inc.

STATEMENT OF DONALD L. MARTIN, VICE PRESIDENT, GLASSMAN-OLIVER ECONOMIC CONSULTANTS, INC.

Mr. MARTIN. Good morning, Congressman. Thank you very much for inviting me. It is both a pleasure and an honor to give my views to the committee this morning.

I hasten to add that these are my views and not necessarily the views of my firm or of my colleagues in the firm.

The title of my presentation is "The Efficiency Defense: An Issue the Congress Must Face in Shaping Antitrust Policy."

Two issues concerning antitrust enforcement policy that are distinguished by their controversial status with the Congress, the courts, and the antitrust agencies and that in my opinion are of great importance are: First, the severe attenuation of efficiency defenses in merger cases that may be brought under section 7 of the Clayton Act; and second, the virtual exclusion of foreign production capacity from consideration in relevant market analyses as proffered by litigants and respondents in the courts and at antitrust hearings, respectively.

As an economic consultant on antitrust matters in both private and government litigation and as a student of antitrust policy, it is my opinion that these issues have never been more ripe for legislative scrutiny.

Unfortunately, time limitations this morning allow me to address myself only to the first of these issues.

The 1950 Celler-Kefauver amendments to section 7 of the Clayton Act were supported in part by the prevalent interpretation of economic studies of the time showing a positive relationship between industry concentration and profits. At that time the law was more concerned with wealth transfers from consumers to business than it was with the inefficiencies of monopoly.

Over the last 10 or so years, the weight of empirical evidence now strongly suggests that the concentration-profitability correlation is driven by individual firm profitability. This means that efficiency, rather than monopoly or collusion, is the likely source of concentration and profits. More efficient firms tend to be more profitable and tend to grow in market share, thus concentration.

Ironically, at a time when we are becoming more enlightened about the concentration-profitability-efficiency relationship we are still saddled with a widely held judicial interpretation of section 7 that denies support for introducing efficiencies as a defense against illegality in merger cases. Since FTC versus Procter & Gamble, the Supreme Court has been unwilling to weigh on a case-by-case basis anticipated efficiency gains from a merger against evidence that a challenged merger may lessen competition. Yet, with efficiencies present cost savings from a given merger may be great enough to cause prices to remain unchanged or even to fall, despite reduction in the number of firms and in the cost of collusion among them. Even if prices were to rise as a consequence of a merger, the loss to consumers in foregone purchases might be more than offset by the gains to society from a more efficient use of resources brought about by the merger itself.

The courts and antitrust agencies have been struggling with the growing evidence that efficiency matters in merger cases, but they have not adopted like approaches, nor have they attached the same degree of importance to the evidence.

The Justice Department through its prosecutorial discretion has determined that it will only consider efficiency arguments in otherwise close cases.

The FTC supports the notion of lifting threshold levels of concentration in an across-the-board acknowledgment of the efficiency effects of most mergers and will consider, at its discretion, efficiency claims in selecting merger cases to challenge.

In private litigation the courts, unless closely bound by precedent, may do as they like. Would-be parties to a proposed merger are thus faced with a spectrum of possible responses to any efficiency claims they might make, depending upon, so to speak, the luck of the draw, or whether their case is to be examined by Justice or FTC, or, as in the case of private suits, in which court their case is to be litigated.

It is time the Congress gave a clear signal to the courts and to the antitrust agencies that efficiency considerations in mergers are indeed important in weighing the public interest effects of any challenged acquisition.

In giving the signal, it is also important that the Congress consider carefully the wisdom of alternative coexisting philosophies employed by the antitrust arms and the courts, which method or methods of accommodating the efficiency effects of mergers is likely to be cost effective and consistent with the public interest, and which methods are not.

Recent econometric studies hold out the promise of being able to isolate the efficiency content of mergers and distinguish them from any evidence of collusion. For example, rivals anticipating gains from a collusion-enhancing merger should see their stock values rise relative to a market index and subsequently fall relative to that index when and if the merger is challenged.

Recent tests of this hypothesis on a large number of mergers provide preliminary evidence that rejects the collusion hypothesis for mergers. Unlike costly engineering studies seeking to quantify alleged efficiencies from a merger and elaborate evaluations of postmerger equities by acquirer and acquiree, this latest research may be more amenable to case-by-case analysis.

It would therefore be useful, instructive, and, above all, in the public interest for the Congress to take the lead in introducing efficiency considerations to its antitrust merger policy.

This concludes my comments. Thank you.

[The prepared statement of Mr. Martin follows:]

PREPARED STATEMENT OF DONALD L. MARTIN

THE EFFICIENCY DEFENSE: AN ISSUE THE CONGRESS MUST FACE IN SHAPING ANTITRUST POLICY

Two issues concerning antitrust enforcement policy that are distinguished by their controversial status with the Congress, the courts and the antitrust agencies and that in my opinion are of great importance are:

(a) The severe attenuation of efficiency defenses in merger cases that may be brought under Section 7 of the Clayton Act.

(b) The virtual exclusion of foreign productive capacity from consideration in relevant product and geographic market analyses as proffered by litigants and respondents in the courts and at antitrust hearings, respectively.

As an economic consultant on antitrust matters in both private and government litigation and as a student of antitrust policy, it is my opinion that these issues have never been more ripe for legislative scrutiny.

Unforturnately, time limitations this morning allow me to address myself only to the first of these issues.

Section 7 of the Clayton Act together with its 1950 Celler-Kefauver amendment prohibits all mergers whose effect "may be substantially to lessen competition or tend to create a monopoly." 1/ The conventional wisdom contained in the Clayton Act is both simple and powerful. A reduction in the number of competitors, may lessen competition by facilitating collusive price fixing among what would otherwise be vigorous rivals. To benefit colluders, the fixed price would have to exceed the competitive price and by logic the cost of

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1/ 15 U.S.C. Par. 18 (1982).

producing. This can only be accomplished if fewer goods are made available to the public. Thus, consumers would end up paying more than the total cost of production inclusive of the return to capital. This represents a transfer of wealth from buyers to sellers that, as expressed in antitrust legislation, the public finds excessive. In addition, since consumers will purchase less at the higher fixed price, their consumption foregone represents a denial of product to them even though they would be willing to pay more than it costs society to produce it. This is socially inefficient and to an economist, if not a legislator, a principal reason to scrutinize mergers. Of course, the same conclusion may be derived if a virtual monopoly were created by a merger.

As I discuss below, it is not obvious from the legislative history surrounding the Clayton Act that the Congress was sensitive to the efficiency, in contrast to the wealth redistribution, implications of mergers. But what if a merger promised to lower the cost of producing goods while at the same time it threatened to lessen competition by reducing the number of existing competitors

and thus the costs of colluding? The sources of such cost savings are many. They may include economies of scale, a more efficient allocation of resources within the new firm, technological complementarily between the parties, specialization in product line, various transaction cost economies and managerial efficiencies. Can we be sure that consumers would be harmed if such a merger took place? Can we be sure that as a general proposition consumers would benefit if such mergers were prevented from taking place? The Clayton Act and judicial interpretation of it have all but rendered these questions moot, since anticipated or demonstrated efficiencies according to the Supreme Court in FTC v. Proctor & Gamble are not a defense against illegality for a merger that may otherwise lessen competition. 2/

Nevertheless, the savings from lowered costs arising out of an acquisition may be far and away larger than the foregone consumption

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2/ FTC v. Proctor & Gamble Co., 386 U.S. 568,580 (1967).

opportunities to consumers, should prices be raised by a collusive restriction of output. In such an instance, society would be denied benefits even though antitrust policy prevented an increase in price by preventing a merger. This seeming anomaly, a lessening of competition together with an efficiency derived net increase in consumer welfare, has received much discussion over the last 15 years. It has a well established literature in economics and is most closely associated with the path-breaking work of Professor Oliver Williamson. 3/ He characterized the problem as a trade-off that the Congress, the antitrust agencies, and the courts have been slow to acknowledge.

Significantly, nothing in economic theory predicts, a priori, that a "lessening of competition" arising from a merger will result in less output just because there are fewer firms and assuming that they collude on price. Indeed, if one firm becomes more efficient,

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3/ Oliver Williamson, "Economies as an Antitrust Defense: The Welfare Tradeoffs", 50 American Economic Review 18 (1968).

it will have a clear incentive to increase production - that is, compete more vigorously. With efficiencies present, cost savings may be great enough to cause market prices to fall (or at worst to remain unchanged) despite the reduction in number of firms. Thus, mergers that tend to lessen competition because they increase concentration may, nevertheless, reduce prices to consumers, although not by so much that they equal lowered marginal costs. Still, such mergers would almost certainly be banned by an antitrust policy that is blind to economic efficiency even where it would unambiguously increase consumer welfare relative to its pre-merger state.

The Celler-Kefauver Amendments were supported in part by the prevalent interpretation of economic studies showing a positive relationship between concentration and profits. In the last ten years, the weight of the empirical evidence and its interpretation increasingly suggests that much of the correlation between

concentration and profitability reflects efficiency effects and not collusion on monopoly. 4/ This constitutes indirect evidence that mergers are potentially efficiency enhancing. Do mergers indeed create substantial efficiencies? Direct descriptive evidence from actual mergers suggests that efficiencies are created in many individual instances. Examples include the formation of Republic Airlines from the merger of North Central Airlines and Southern Airways; Heileman's successful growth based on purchasing many small breweries and Philip Morris' purchase of Miller Brewing Co.; and Jones and Laughlin's (LTV) purchase of Youngstown Steel. There are also examples of economically disastrous mergers.

Unfortunately, because of methodological and data problems with accounting and stock market sources pertaining to the immediate merger parties, econometric evidence supporting firm conclusions about the generality of merger created efficiencies has been too difficult to isolate with sufficient confidence. However, more

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4/ See Paul Pautler, A Review of the Economic Basis for Broad-Based Horizontal Merger Policy (FTC Staff Working Draft, October 1981, forthcoming in the Antitrust Bulletin).

recent econometric studies employing a methodology that accounts for the effect on close competitors of merger announcements and subsequent merger challenges by the antitrust agencies, promises greater success in isolating the efficiency content of acquisitions. 5/ A merger that holds out the prospect of facilitating collusion among rivals should reflect the anticipated profits of those rivals by raising their stock prices relative to the market. Should such a merger be challenged by antitrust agencies, profit prospects for rivals should fall and with them the price of their stock relative to the market. A failure of relative stock prices to fall would constitute evidence rejecting the collusive model. This newer literature provides some preliminary evidence that past regulatory activity of both the Justice Department and the Federal Trade Commission, by ignoring considerations of efficiency enhancement, have likely prevented the

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5/ Bjorn Espen Eckbo, Examining The Anti Competitive Significance of Large Horizontal Mergers, (Unpublished Ph.D. Dissertation, University of Rochester, 1981).

consummation of numerous non-collusive and socially efficient mergers. 6/

The legislative history surrounding Section 7 and the 1950 Celler-Kefauver Antimerger Act is distinguished by a failure to express substantive concern for the possible pro-efficiency consequences of mergers. 7/ This failure, I believe, for awhile led to perversity at the regulatory agencies and in the Courts where mergers that enhanced efficiency were feared to so disadvantage rival firms that they were ruled anticompetitive and prohibited. 8/ This jaundiced view of the efficiency issue was eventually repudiated in FTC v. Proctor & Gamble (1963) 9/ but the Supreme Court in affirming

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6/ Ibid., p. 86.

7/ Alan A. Fisher and Robert H. Lande, "Efficiency Considerations in Merger Enforcement", 71 California Law Review 1592 (December 1983).

8/ See Foremost Dairies, Inc., 60 FTC 1049, modified, 67 FTC 282 (1965).

9/ However, it is not obvious that this view has been universally embraced. As recently as 1979, the Justice Department (in U.S. v. Occidental Petroleum Corp.) argued that efficiencies should count against a merger. See Oliver Williamson, "On the Governance of the Modern Corporation", 8 Hofstra Law Review 63, 69-72 (1979).

(1967) the FTC ruled that efficiencies were not an issue to be debated on a case-by-case basis. 10/ By ignoring the efficiencies issue altogether, the Court seems to have compounded the problem.

Of course, there are probably many non-efficiency motivated mergers and I do not suggest that all mergers that may threaten to lessen competition also tend to yield efficiencies. Nevertheless, mergers are contemplated and undertaken regularly in anticipation of cost savings, among other benefits. As mentioned above, scholars in antitrust economics and industrial organization have brought recent evidence to bear that, at the very least, challenges the conventional wisdom that concentration and profits are generally manifestations of market power. More pointedly, the evidence on the association of concentration and profit may reflect efficiency rather than market power. 11/ In my opinion, the weight of the evidence strongly suggests that the Congress give a clear signal to the courts

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10/ FTC v. Proctor & Gamble, op cit.

11/ Supra notes 3 and 4.

and the antitrust enforcement agencies that efficiency considerations are relevant to any merger analysis contemplated under Section 7 and that anticipated efficiencies should be viewed as a positive factor to be weighed against any potential threats of market power through acquisition.

Presently, in the face of growing evidence that efficiencies arising from mergers are non-trivial, the antitrust agencies and to some extent the courts are wrestling with the problem of accommodating both efficiencies and market power in merger enforcement. The FTC in its Statement Concerning Horizontal Mergers states explicitly that it will consider evidence of expected efficiencies on a case-by-case basis in its discretion in issuing complaints. 12/ It also supports the view that market share thresholds may be lifted to account for economies of scale factors but not other sources of

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12/ Statement of Federal Trade Commission Concerning Horizontal Mergers, pp. 8-9.

efficiencies. 13/ The Justice Department, too, has acknowledged that it may, under its prosecutorial discretion, consider efficiency factors in otherwise close cases. 14/

It is obvious from the above that would-be parties to a given efficiency-oriented merger may be subject to very different treatment depending on the "luck of the draw" or whether their case is processed at Justice or the FTC.

It is my belief that some guidance from Congress is most appropriate here.

13/ Ibid.

14/ U.S. Department of Justice, Merger Guidelines, pp. 42-43.

Representative LUNGREN. Thank you very much, Mr. Martin.

Next we are going to hear from Mr. Thomas DiLorenzo from George Mason University.

STATEMENT OF THOMAS J. DiLORENZO, PROFESSOR OF ECONOMICS, GEORGE MASON UNIVERSITY

Mr. DILORENZO. Thank you for having me.

For too many years antitrust policy has paid inordinate attention to industrial concentration. Government policy toward industrial concentration has always been based more on emotion than on reason. This has reduced the Nation's productive capacity and international competitiveness.

One of the problems is the mistaken view that market structure, for example, concentration, determines business conduct. That is, that in more concentrated industries where only a few firms dominate, business conduct is likely to be monopolistic. In the past several decades, however, economists have rediscovered that the opposite is true: Business conduct determines market structure. For example, if one or a few firms produce a particularly good product at lower prices than the competition, they will eventually dominate the industry.

One example of this is the ready-to-eat cereal industry where Kelloggs, General Mills, and General Foods became very efficient at meeting the diverse demands of American consumers by inventing different brands of cereal that have become enormously popular and very profitable. These companies have done exactly what consumers wanted them to do: They offered a wider selection at competitive prices. The antitrust authorities, however, took the view that since these firms were "dominating" their industry they were necessarily monopolizing it despite the absence of any evidence of monopoly pricing power. This is what Prof. Yale Brozen of the University of Chicago called antitrust upside down.

Unfortunately, this is the predominant approach to antitrust policy. We are penalizing success and competitiveness. In the absence of legal barriers to entry, the only way any firm can dominate its industry for an extended period of time is to offer a superior product and/or lower prices. Among the reasons why industries may become concentrated are accumulated experience in certain firms, economies of scale, superior management, capital-intensive technology, and greater investment in the training of workers, to name a few. Thus there is reason to believe that industrial concentration is evidence of competitiveness, not monopoly.

The contrary view that concentration leads to collusion and therefore to monopoly has been supported by a number of statistical studies done largely prior to 1970. These studies found a positive correlation between concentration and profitability. The authors then assumed that this was evidence of collusion. These results are sure to have influenced antitrust policy, but a larger volume of more recent research has cast serious doubts over what is called the concentration-collusion doctrine.

I can do no better than to quote Prof. Yale Brozen who in a recent treatise, "Concentration, Mergers, and Public Policy"—New York, MacMillan, 1982—summarizes the results of these more recent studies.

That higher profits believed to exist in more concentrated industries can be attributed to collusion is an invalid inference because:

First, accounting profits are positively related to concentration only in some years, not all years.

Second, if collusion were the source of excess profits, not only would large firms be more profitable in concentrated industries than in unconcentrated but smaller firms in concentrated industries sheltered under the price umbrella of colluding major firms would be more profitable than the smaller firms in more atomistic industries. They are not. Also, the second largest firm tends to be less profitable than the largest in concentrated but not in dispersed industries. This indicates that the efficiencies of large size and superior performance are major reasons for high concentration.

Third, the largest firms in almost all industries are more productive than smaller firms in the same industries. Since leading firms constitute the bulk of a concentrated industry, average profit rates in such an industry will be above the average of all industries to the extent that higher profits accompany lower costs. This circumstance, and not concentration, caused the positive concentration-profit relationship in those years in which it occurred. Profits in concentrated industries were found to be a result of 20 percent lower costs accompanied by 10 to 15 percent lower prices than would prevail following the dissolution of the leading firms in concentrated industries.

Fourth, the concentration-profitability relationship weakened or disappeared when other causes were admitted into the design of regressions. The correlations that had been found were weak. They weakened further when some of the omitted variables explaining accounting measures of profitability were incorporated into profit-concentration regression.

Fifth, profitable concentrated industries (and profitable diffused industries) were shown to be profitable because of disequilibria. Unanticipated changes in demand or in cost had created the situation. These disequilibria were temporary. They disappeared as competition led to adjustments moving these industries toward long-run equilibria.

Thus the continual attack on industrial concentration and on mergers is based largely on emotional fears and biased data. Breaking up the largest firms in concentrated industries is likely to increase the costs of production and therefore the prices to consumers. It merely serves to protect smaller, less efficient producers. This is a destructive policy in an increasingly competitive international market.

The antitrust restrictions on merger activity pose a serious threat to productivity and competitiveness. One basic function of mergers is to transfer assets from poor to good management. The market for corporate control disciplines corporate management in ways that make it more efficient. Those managers who are least efficient are threatened with a takeover bid, the end result of which is that they lose their jobs to a more efficient management team. This is why businessmen have been at the forefront of lobbying efforts at the State and Federal levels of government to have legislative restrictions placed on "unfriendly" mergers. Such mergers may be unfriendly to inefficient managers, but not to shareholders, workers, and consumers. Preventing such mergers would decrease the rewards to successful management, decrease entry, stifle the efficiency of the capital markets, and reduce productivity growth. A slower rise in wages and income will be the result.

In addition, it is important that measures of industrial concentration—concentration ratios—really have very little meaning in terms of the competitiveness of an industry. For one thing, they ignore the existence of substitutes. Even a pure monopolist may have no market power if there are close substitutes for his product. Concentration ratios also ignore international competition. The U.S. auto-

mobile industry may be concentrated, but no reasonable person would claim that it is anything but fiercely competitive, given the recent inroads made by the Japanese and West Germans, among others.

A third problem, is that concentration ratios say nothing of potential competition. Even if concentration was conducive to monopolization, above normal economic profits will soon attract entrants.

Finally, concentration ratios are arbitrary—for example, why 4-firm or 8-firm and not 3- or 9-firm ratios—and therefore they are meaningless. Despite these difficulties, the antitrust authorities continue to use concentration ratios as though they were actually meaningful.

In summary, there are at least two serious problems created by this attack on industrial concentration.

First, antitrust policy has imposed heavy burdens on some of our most productive firms and industries, thereby diminishing productivity growth, employment and income.

Second, these witch hunts divert attention from the real source of monopoly power: Government sanctioned restraints of trade such as tariffs, quotas, whether they be voluntary or involuntary as the current language puts it, monopoly franchises, occupational licensing, grandfather clauses, and so on. This has always been the case with antitrust.

Senator John Sherman himself, during the Senate debates over his bill in 1889, objected to trusts and combinations on the grounds that they "subverted the tariff system; they undermined the policy of government to protect * * * American industry by levying duties on imported goods." (Congressional Record, Senate, 51st Congress, 1st session, June 1890.)

Sherman was concerned that the monopoly profits earned by his business supporters because of protective tariffs were being eroded by the trusts and combinations. For, as his colleague, Congressman Mason stated during the same debate, "Trusts have made products cheaper, having reduced prices."

It was Senator Sherman who, 3 months after the passage of the Sherman Act, sponsored a bill known as the campaign contributors' tariff bill which increased tariffs on manufactured products immensely. This is the legacy of Senator Sherman and the Sherman Antitrust Act. It is time we told the truth. Government regulation, including antitrust, is the source of the monopoly problem in American industry, not the solution. A tremendous amount of time, effort and money is spent by businesses, unions, and other interest groups in lobbying efforts to secure special privileges from the Government. The fact that these resources could have alternatively been used in production further worsens the productivity of the economy. Furthermore, much protective regulation occurs in very deconcentrated industries wherein dozens of relatively small firms join forces in their lobbying efforts. Industrial concentration does not necessitate either economic or political power. Thank you.

Representative LUNGREN. Thank you for your statement.

Let me ask all three of you to respond to a question that I asked Chairman Miller, and that is, is there evidence one way or the other that industrial concentration has increased over the last two decades? Or has it declined during that period?

Mr. ARMENTANO. I think the answer that Miller gave is the correct one. In fact you could even go farther than Miller. If anything, some measures of industrial concentration have declined historically. So rather than simply argue that concentration has stayed about the same, which one could argue in some areas, some measures of concentration may have actually declined.

I think the more important question is the meaning of industrial concentration. In other words, whether that is a meaningful expression, whether industrial concentration tells you anything about the competitive proces I do not believe that it does.

Mr. DILORENZO. The problem is the approach we have been criticizing for the most part, concentration ratios, are industry-wide, but the people who are claiming that there is a dangerous trend toward aggregate concentration deal with aggregate concentration ratios—the whole country. And they are particularly meaningless, given all the criticisms that are made on industry-wide concentration ratios.

The data show that even if it were true that aggregate concentration was meaningful, it has not been becoming more concentrated. With technology advancing as rapidly as it is and transportation costs much lower than they were 30 or 40 years ago, international markets are very competitive and render those ratios meaningless.

Mr. MARTIN. I believe Chairman Miller was making reference to the aggregate concentration ratio when he did say that it had remained roughly constant for the last so many years. The work that he cited, some of the original work by the late Warren Nutter from the University of Virginia, also pointed to the fact that concentration had remained roughly constant in the aggregate sense. But it is not a very meaningful measure of market power. If concentration ratios (or other measures, Herfendal indices, Genie coefficients etc.), are to have any meaning at all, one would have to look at particular markets, product markets and geographic markets to make any kind of intelligent statement about them. Then ask the question, well, what do they mean once you have identified the relevant product and geographic markets?

Representative LUNGREN. I would like to again ask the three of you to respond to a statement that Yale Brozen makes in that treatise which two of you referred to. He says that Prof. Joe Baine found, as did F. L. Pryor in a later study, that industries that are concentrated in the United States are concentrated in other countries. Those with low concentration are also the same abroad as in the United States. This suggests that fundamental technological and economic forces determine industry's structure.

I ask the three of you to comment on that.

Mr. ARMENTANO. I would certainly agree with that. What he is saying, I think, is that there are basic economic factors such as scale economies, advantages associated with mass production, or the absence of those factors that determine market structure. I think we have to say that industries are concentrated to the extent that factors such as economies of scale exist. To the extent that they do not, industries are not concentrated. Whether you look at America or at international markets you see the same general phenomena.

Mr. MARTIN. I would not limit the sources of concentration to just scale economies. There are lots of other types of efficiencies that are possible for firms to achieve beside scale economies. These include the

managerial efficiencies and transaction cost efficiency, specialization in product line efficiencies, et cetera. These widen the sources of concentration.

I would also agree with Professor Brozen's observation that there are fundamental sources of market structure, relative prices, technology, and so forth, that spread throughout Western economies and are not limited to particular industries and particular countries or particular sectors of an economy, and to that extent we should not really be surprised to see similar market structures if, in fact, the elements that determine those market structures are similar across nations.

Representative LUNGREN. Let me put a general statement to the three of you. Obviously you have a great deal of difficulty with an analysis that is based on concentration, and I think you make some very, very valid points there. Let me ask how you would explain this problem to the average citizen who has grown up in this society, perhaps taken Economics I, and learned that antitrust basically seems to be rooted in the fact that we do not want concentration. They do not articulate it quite that way, but that seems to be the story that comes across. Chairman Miller talked about how the notion, the more competitors the better the competition, seems to come out in much of our teaching.

There is and always has been a populist mood in this country politically.

How would you explain to the average citizen, consumer and voter the benefits to be derived from your analysis of failed antitrust policy? In other words, if we were to take the corrective actions that you have mentioned, how would you explain them to the average citizen? Why should he or she be less concerned about concentration and more concerned with this analysis which suggests that greater efficiency will in fact produce greater benefits for him or her?

Mr. MARTIN. Let me try that. I have been out of the classroom for a few years, but I have been in front of juries where I have had to get my ideas across in a way that economists are not used to.

First, Chairman Miller was correct in placing part of the guilt of this myth of large numbers of firms at the feet of economic instructors or professors of economics, and I am just as guilty perhaps as anyone else, since I have been a professor of economics. The appropriate statement for an Economics I class is something like there should be a sufficient number of firms so that no one firm can affect price by withholding output. That does not necessarily mean that the larger the number of firms the better off we are. It means that if we had one firm it might be able to affect price in the market. If we had two or three it is not clear whether any one of them would be able to, by withholding its productive capacity, affect price and therefore to manifest market power.

So to any student in an economics class, I would say, it is not the absolute number of firms that counts. Rather it is whether or not firms themselves, irrespective of their numbers, have the power to affect price. There could be a large number of firms or there could be a small number of firms. The ability to affect price depends on other factors in the market, such as entry.

One thing that I think is important to communicate to students is that it is not just largeness that counts. Just like bigness is not bad, largeness is not necessarily good. The large numbers are not necessarily

good, because you may sacrifice something else. There are economies of scale to be had by larger volumes of production. The smaller the firm, the less that firm is able to take advantage of those economies of scale if they exist, and so obviously we do not want to have so many firms that none of them will be able to take advantage of lower costs by increasing volume.

To the extent that we limit the number of mergers, for example, or to the extent that we demand that we have a large number of firms, we might miss achieving lower costs and therefore lower prices than otherwise might prevail, and to that extent it must harm consumers.

So giving up efficiencies may be a relatively high price to pay to worship at the altar of atomistic competition.

Mr. ARMENTANO. I think the easiest way to do it, and this is the way I would explain it to a lay audience, is to turn to the audience and say, well, how many companies do you want in this industry? Because utimately it is going to be consumer choice which is going to determine the market shares of the company, the numbers of companies and their concentration ratios. So how many companies do you want to support?

Let me give you an example of that. We have a rule, although no law, that limits so-called predatory pricing. Firm A drops its price and allegedly that action would tend to drive the other company from the market, increasing concentration and producing all kinds of bad results. But that never happens in a real market. The only way firm A can drive firm B from the market is if consumers look at the lower prices that firm A is charging, like those lower prices, and channel their dollars from B to A. Consumer choice will ultimately determine the number of companies in the market and the market shares of the companies. There is no way that predatory prices can work if consumers ignore the lower prices and keep buying the products of B, C, D, and E. And if they do work, they only demonstrate that consumers control market shares.

You don't have to get into the business of trying to figure out what the market shares should be or how many companies there should be. Consumers will do it for you. If the consumers decide there will be fewer firms there will be fewer firms; if the consumers decide the market share of the leading company will go up, it will go up; if they decide it will go down because they are buying the goods of B, C, and D, then it will go down.

There is no useful role for antitrust policy or for economists in this area. We do not have any special knowledge on what concentration should be, or what the numbers of companies should be, or whether there are in fact economies of scale or not. The only way to find out is to open the market and see what occurs. If the market shares increase, that tells you something perhaps about efficiency and choice on the part of consumers. If they go down, that tells you something too.

What useful role could antitrust policy play in this area? All you would be doing is substituting the knowledge and the guesses and inferences of the Justice Department or the Federal Trade Commission for the inferences and guesses and hunches of the consumers and businessmen in the market. I do not know why they would have any special knowledge in this area that market participants do not have.

Mr. DiLorenzo. If I were to convince a lay audience or to advise them, the first thing I would do is read over Mr. Armentano's book "Antitrust and Monopoly," because it is filled with specific cases and examples of some of the things we have been talking about.

You cannot talk to a lay audience in terms of concentration ratios and economic issues. One example I would use in particular is the automobile industry. For decades it has been used in economics texts as an example of entry barriers of monopolized industries where above normal profits persisted for a long time. There are economies of scale that now point to the fact that with international competition it is ludicrous to think that economies of scale are a cause of entry barriers in the automobile industry.

I would pair that with the example of the tobacco industry. There are literally thousands, at least tens of thousands of tobacco producers in this country. So it is probably one of the least concentrated industries in this country, although it is grandfather claused in; there is a grandfather clause that severely restricts the supply of tobacco and therefore drives up the price.

I think you have to go to examples like that to illustrate the contradictory nature of what we call the concentration-collusion doctrine that we have been talking about.

Representative Lungren. Let me ask this. You mentioned, Mr. DiLorenzo, the breakfast cereal case, and that makes me think of what Thurow and others have talked about, and that is the factor of "substitutes" that you have to bring into your analysis. It just strikes me that people do not just eat cold cereal for breakfast. There is a whole panoply of possible substitutes. How do you determine what the truly relevant market it?

Mr. DiLorenzo. You cannot.

Representative Lungren. You say it is all going to be cold cereal. But I do not eat cold cereal. I like hot cereal. Sometimes I do not eat any cereal at all. What in fact is the universe that economists would deem the relevant universe for making decisions of that sort?

Mr. DiLorenzo. Well, I agree. It is very difficult, if not impossible, to define that market. I would not advise any economist to think that he could do that. I guess I was not too explicit on substitutes. I just mentioned that substitutes were important. You hit the nail on the head there. How do you define the cereal industry? It is not only ready-to-eat cereal; it is all cereal, and bacon and eggs, and everything else. If you define it more broadly, these concentration measures become even more useless.

Representative Lungren. As a Member of Congress I have heard complaints of all varieties from all different sorts of people and many of my constituents, and I have yet to have any of them come up to me and demand that I do something about cold cereal, other than parents thinking there is a little bit too much sugar in them. But that is their own problem. I really have never seen an outcry coming from the grassroots articulating this as a terrible problem, that the new Standard Oil of this period of time was now Kelloggs and General Mills.

Mr. Armentano. That was the case that tested the law; that was the case designed to test and see whether close-knit oligopoly could

be attacked under the law. There is no intelligent reason for that case other than to see whether you could get a conviction and whether that would broaden the scope of FTC jurisdiction.

Representative LUNGREN. Let me ask the three of you this. One of the purposes often stated for antitrust law is to prevent collusion between businesses. What does history tell us about the stability and durability of cartel arrangements?

Mr. MARTIN. Perhaps one of the more durable cartels and also a telling example of the problem of cartels is OPEC, up until very recently. When I was at the University of Virginia many of my colleagues would argue that this thing was going to break down in 10 seconds, that it was just going to fall apart, and we were all very amazed to see that it did not fall apart quite that quickly. But you did observe lots of cheating going on, even in a cartel of governments where perhaps the profit motive and greed did not operate as a way to destroy OPEC.

The history of private cartels in this country, for-profit cartels, has been a disaster. The plans of mice and men have never been more thwarted by cartel propositions that have encouraged cheating. There are so many cases and attempts at it.

For all those attempts at cartelizing there are many people who have been prevented from entering into cartels precisely because they did not feel they would work, and the reason they did not is because of the history of them. They fall apart, and they fall apart for one important reason: Some member or members of a collusive organization sees an opportunity to cheat on it because they believe that others will not. If they believe that everybody else will hold their prices higher, they can somehow cut their price clandestinely or change the quality of their product clandestinely, and therefore get more wealth for themselves while everyone else is holding still. That rarely lasts very long and the history of cartels is one of failure.

Representative LUNGREN. I guess you would agree with the other two gentlemen on the panel that if you want to maintain a cartel the best way to do that is to create Government barriers to entry.

Mr. MARTIN. Yes, and the broadcasting industry is a great example of that. The example of the tobacco industry is another one. Whereas, interestingly, you have a lot of atomistic competitors in the tobacco industry, the licensing laws are such that it keeps the price of tobacco high, and since you cannot transfer your license to another plot, it affects production to a certain extent. The economic rents or monopoly rents that would otherwise prevail are captured by the original owners of the property and not by any new owners of tobacco land.

But yet that cartel is enforced and run by the police power of the state. Restriction on entry into broadcasting, restriction on entry more or less into the trucking industry, the restriction on entry into the airline industry up until recently have all been successful manifestations of the police power of the state. If you want a cartel to last a little bit longer you have got to get the state involved. The ICC is the perfect example. Two of the best examples of cartelization in the country are the railroad industry and the trucking industry.

Representative LUNGREN. I was reading an article—I guess it was part of Yale Brozen's book—about two economists talking about the trucking industry. One was trying to give the example of the ICC as

a Government barrier to entry. The other economist was not even aware that you could not go out there and start operating your own trucking firm without first meeting all the requirements of the ICC. It is so much taken for granted, and at the same time many people do not realize the pervasive nature of the barrier to competition that we have created.

Let me ask this question. It may be slightly off the specific topic, but it is one that surfaces in this Congress on a regular basis whenever we are talking about the oil industry, and it often arises when we are talking about deregulation and so forth. The comment is made that, look, you have got these major oil companies which are so concerned about making sure that the harnesses are taken off so that they can produce to help us domestically, yet they take their capital and buy something entirely outside their area. I guess the example is given of one of the major oil companies buying Montgomery Ward a couple of years ago.

How would you explain that in the context of your argument, that mergers do provide an economic benefit and that we ought not to be as concerned as some are about eliminating those?

Mr. Armentano.

Mr. ARMENTANO. It seems to me there are a couple of ways you can answer that. One way is to look and see whether the rates of return in oil are lower or higher than they are in other areas. If we look at the data and see that they are lower, then it is fairly easy to explain why an oil company might diversify out of its own area. And this might be true especially in a period where oil prices are regulated and where the rates of return end up being regulated.

Then one can make all the standard economic arguments about the advantages associated with integration, with one company buying another. The fact that it is an oil company really does not make any difference at all. Here I would support the argument that Chairman Miller has made, that Don Martin has made, on managerial efficiencies and financial efficiencies and the like.

I do not think that it is necessary to come up with some sort of special justification for oil company mergers. It is true the oil industry is always under special scrutiny, but if you look at the history of the oil industry, it has been one of the most vigorously competitive industries that we have ever had. I have charted oil prices from 1860 until 1982. You just cannot find an industry that, from my point of view, has a better competitive record than the oil industry. Prices historically have always tended downward in that industry. The only exceptions are war years, which are exceptions for almost every industry.

Please hear me correctly. I am not saying that there is nothing to be regretted concerning the behavior of the oil industry. We were talking about cartelizations before. The longest running oil cartel in history is not OPEC, but the prorationing cartel administered by the oil producing states, and that cartel was in existence and functioned effectively from 1931 until 1971. It restricted production and kept oil prices higher than they would have been in the absence of those legal restraints. That is a legal cartel and I oppose that.

I am not making a brief for the oil industry, but I am saying that in an open, unregulated market there certainly is nothing to be regretted generally about the behavior of oil companies.

Mr. MARTIN. Another point that I think ought to be remembered, and that is that the oil industry just came off regulation. If you recall what happens to landlords who have just come off rent control, they do not put their money back in houses that quickly, because they do not know whether the rent control is going to go back on again.

So some of that investment that you see leaving the oil industry and going to other industries is going to unregulated industries where there is a chance that the return on the investment will be higher.

So part of that handwringing about no production from the oil industry or no investment from the oil industry back into the oil industry is really something that the Congress should not be surprised about. We reap what we sow.

Representative LUNGREN. It also strikes me that if those who direct a company truly do have an obligation to their shareholders, they must consider at some point where they are going to get the best benefits for that shareholder, and if it is outside the oil industry or partly in the oil industry and partly outside it, merger or acquisition may be a very rational decision to further the interest of their shareholders.

Let me ask this. We have touched on it a little, but I would like you to talk about it a little bit more. When a publicly traded corporation is poorly run its stock prices tend to reflect this fact, creating an incentive for a better management team to take it over to more efficiently employ its assets. How important do you think this market, if we can call it that, for corporate control is? Does this type of a market contribute to economic efficiency even if the number of the firms in the industry declines?

Mr. DILORENZO. I think it is very important. The evidence that it is important is that, for example, in the State of Maryland they just passed a law restricting what they call unfriendly takeovers, and there has been one proposed at the Federal level about a month or so ago. It has been largely businessmen who are fearful of takeovers that are proposing it. I think that is the evidence that it is in the interest of consumers, shareholders, and workers to have a well functioning market for corporate control.

In the State of Maryland it came about, I believe, because of the takeover battle between Bendix and Martin Marietta which put fear into the hearts of a lot of businessmen who did not want to be taken over in that way, and they turned around and lobbied the Maryland legislature for a restrictive law on mergers.

It has become part of the common knowledge in economics that the market for corporate control is very important in disciplining management.

Representative LUNGREN. Are there any specific studies on that? Are there any major studies that perhaps would be of benefit for those of us in Congress to take a look at?

Mr. DILORENZO. The original piece was by Henry Manne in the Journal of Political Economy in 1945, called "Mergers and the Market for Corporate Control." It was a theoretical discussion of just this, these things we have been talking about, and since then there have been at least dozens of statistical studies done on the market for corporate control. You can dig those up in the footnotes of any industrial organization textbook, I would believe, and there has been a good bit

of support for how well or how not so well the market functions. But it does serve that purpose.

Mr. MARTIN. I can direct you to some work also in the Journal of Political Economy by Prof. Louis DeAlessi from the University of Miami Law and Economic Center. His work also deals with the market for corporate control, extending some of Professor Manne's work and also drawing on his own research.

Representative LUNGREN. Let me try to put into a political context why what you as economists may see as self-evident is not so self-evident when it filters through to the Congress. At the time that this big takeover fight was taking place, the one you referred to that may have caused the law to be changed in Maryland, we in the Congress were also very much aware of the fact that interest rates were rather high and that many felt there was a scarcity of capital. That was happening at the very time this messy fight was taking place. Whether it was good or bad, it was certainly messy and was spread all over the papers. The argument then was made, whether it was a true argument or not, that this was a prime example of the waste of capital at a time when capital was particularly scarce, and therefore, how can this sort of activity truly be a positive in terms of the overall economy.

Mr. DILORENZO. I do not know if you will have any success in convincing your colleagues in the Congress. As I see it, one of the major functions of the Congress is to blame the private sector for the problems it creates.

Representative LUNGREN. You have noticed that. [Laughter.]

Mr. DILORENZO. That is what the Congress is for, I believe.

To the extent that interest rates are high, I am sure we can blame it on the Federal Government for allocating, in addition to the deficit, over $150 billion off-budget borrowing and so on. But the basic economic problem here, in this particular case, is that you have to recognize that the information that businesses need to have to operate efficiently is very imperfect and very costly to obtain, and what this market for corporate control is is a way in which we find out which businesses are more efficient. It is through this whole process of takeover bids that we can find out which management teams are better and so on. To criticize this as wasteful is just to criticize the fact that we have imperfect information in the world. That is not much of a criticism. It is pretty much saying that if we were all omniscient and knew which management team was best we could pick them, but the only way you could know that is to try it out through trial and error.

So I think the whole idea of criticizing this market for corporate control is unfounded.

Representative LUNGREN. So what you are suggesting is that this market for corporate control actually functions as a discipline on the overall economy; because the information is imperfect, it is a valid means of decisionmaking to find out if corporate management is doing a good or a bad job.

Mr. DILORENZO. No one at the FTC or in the Congress or the Justice Department knows which management is best for what they should be doing. The only way we could know that is through the market to find out who charges the lowest prices and offers the best product. The market for corporate control helps us find that out, and that is some-

thing that is always ignored by the critics of the market for corporate control.

Mr. MARTIN. Also, the owners of that scarce capital that we were talking about do not own it on a costless basis. If they devote resources to one endeavor versus another, there is an opportunity cost of what that capital could have done. Not only do the managers of the corporations that also own stock feel that cost, but of course so do the stockholders themselves, and the stockholders have an opportunity to vote whether they prefer this type of takeover or not or whether they prefer being taken over or not by getting rid of their shares. So to that extent, they can send a very clear signal to the market about what possibilities and opportunities are associated with any particular takeover activity. These activities are really not done in smoke filled rooms behind closed doors.

Reresentative LUNGREN. As a matter of fact, you could not get away from that major one. It was on television and in all the newspapers, and in fact we made some personalities out of some people involved in that. Celebrities, I guess, we made out of them.

Mr. MARTIN. That is exactly right. That has very little to do with the determination of nominal or real rates of interest in this country. The two things really ought not to be discussed in the same sentence or in the same context.

Representative LUNGREN. I agree with you, but sometimes we need some expert testimony to give us some backup.

Let me ask you, Mr. Martin, to respond to the major conclusion that I thought I heard from your two colleagues; that if we are going to do something in this area, we ought to do it in terms of ridding ourselves of governmental barriers to entry and moving forward more vigorously in the deregulatory mode.

Mr. MARTIN. I could not agree more with that. Even though the current administration has made some efforts in that direction, I think that there are still a lot more efforts to be made, and therefore a lot greater returns to be had from moving forward in the deregulation area.

I mentioned the broadcasting industry. The communications industry in general is an extremely important area. There is an industry for the future. It is happening right now. The current Chairman of the Federal Communications Commission has a view toward deregulation that I sympathize with. However, there are very strong forces operating to slow down that deregulation program largely because there will be shifts in wealth as more efficient competitors attempt to get into that market. That is why I think there is so much difficulty deregulating in communicators.

But that is not the only one. The shipping industry is another area. Other parts of the transportation industry are still other areas. The governmental support in some of our professions, regulation in those professions, ought to be looked at very carefully, although there are some good arguments for self-regulation and for Government regulation. But it ought to be looked at with a new view, one that is much more attune to consumer's welfare than to business welfare, than it has been previously.

Representative LUNGREN. When you mention networks--I do not want to beat up on the networks—but I do recall that when they were doing nightly stories about the tremendous profits that the oil companies had and failed to mention the down years, that they never mentioned their own profits were far in excess of just about any other corporate category you could come up with.

I would like the two other panelists to respond to Mr. Martin's suggestion of working efficiency defenses into the existing antitrust analysis and legal structure.

Mr. Armentano.

Mr. ARMENTANO. Well, if we could not do anything else with the antitrust laws, it might be a good argument. But as I point out in my book, that defense itself has all sorts of problems. What we mean by efficiency in neoclassical economics is very different, I think, from what Tom and I are saying efficiency is. From our perspective, the only way you can discover what is actually efficient is to have an open, competitive market, and to get into discussions of efficiency at court I think throws you back into static neoclassical theory, and into standard discussions of costs and benefits, which I have serious problems with.

So I do not think that it would be wise public policy to encourage that sort of legal defense. I would rather see a movement to abolish section 7 then to try to work within the antitrust laws to establish a rule of reason.

It could be argued that a rule of reason is better than the existing approach. I am not going to deny that. But what I am saying is that the conventional notion of efficiency in economic analysis is inappropriate, and to establish an efficiency defense with an inappropriate theoretical foundation, which is, I suspect, what would happen, is to legitimize the process and ultimately not to achieve the objectives I am interested in achieving.

Mr. DILORENZO. I very much agree. Giving the antitrust authorities a role in defining what is efficient is what has gotten us into this mess in the first place. For example, they have been trying for years to say something about what the optimal size of a firm or industry should be. The only way we know what the optimal firm size is, is to observe those businesses out there, and if they settle on producing 50,000 widgets per year and that persists for 5 years, then that is apparently the most optimal size plant. But you cannot legislate that; you have to let the market reveal that: that is the only way to know it.

The whole idea that the antitrust authorities can define efficiency is just contradictory. I would also be afraid that when they are given that role formally or informally there is nothing, of course, to guarantee that they are going to listen to the great advice Mr. Armentano has offered. It is a political institution and the only way to get rid of the pervesities is to not give them a role at all in defining efficiency.

Mr. ARMENTANO. The standard discussion of collusion, for example, is that collusion is socially inefficient. And even though the antitrust laws, at least the current administration of them, has been reformed, the approach to collusion has not changed at all. In fact, if you had asked Chairman Miller what kind of resources he was devoting to price fixing activity, he would have said, I would think, that a good share of the resources at the FTC have now been shifted into detecting

colluders and price fixers and market dividers, the presumption being, based on standard neoclassical analysis, that price collusion and market division agreements are socially inefficient. But I disagree with that.

I think one could make a good argument that social efficiency is only revealed in the market, and if so-called collusive agreements survive in open markets, then why not draw the standard welfare conclusions that these agreements are in fact efficient.

It may be true that collusive agreements will not survive in open markets. Well, then fine. I do not have any objection to that. I am not saying that collusive agreements ought to survive; I am not saying we ought to make it easy for them to survive by creating legal barriers to competition. But if in fact they do survive—for example, say the air carriers are given permission to make collusive agreements to restrict discount fares in their industry—I think we could make a good argument that that, in fact, is an efficient arrangement.

So the problem with most efficiency discussions is that you fall back into standard arguments, standard theoretical arguments, which I think are arbitrary and ultimately wrong, arguments that have been given up in every other area of antitrust. I am not at all sure that price agreements are not efficient. Ten years from now, you will be holding hearings and it will likely be demonstrated that someone has determined, employing some sort of econometric model, that price collusion agreements are efficient in the traditional sense. But why should we wait for that?

Representative LUNGREN. Mr. Martin, would you like to respond?

Mr. MARTIN. Well, we have an opportunity for disagreement among economists, which is so rare that I would not want to miss it. [Laughter.]

My problem with the comments made by my colleagues at this table, although I might agree with them in spirit, they are Panglossian in effect. I have trouble with the statement that what exists is optimal or what exists is the best of all possible worlds, otherwise it would be different, and that is kind of the statement you are being given today.

As I say, in spirit, I think the market does provide and find those efficiencies. The question to ask the gentlemen on either side of me is, could you recognize monopoly or collusion or a cartel or a reduction in consumer welfare through collusion if you saw it, and what would you do about it? Or could you recognize it if it were not a Government conspiracy and what could you do about it?

As a positive scientist, as an economist looking to test propositions, I find that the statements that they are making this morning make it difficult to test the philosophies or the propositions they are giving you, and to that extent, I disagree with what they are saying.

Representative LUNGREN. I would suggest that we could probably go on for quite a while on this. I just want to thank all three of you for appearing before us. This is an issue that I really do think needs to be fully thought out and ventilated before the Congress, because, as I suggested at the outset, oftentimes when we are dealing with what the implication of antitrust policy is, or industrial policy or whatever, we forget to look at what antitrust policy is and whether the assump-

tions upon which we are currently operating are necessarily the proper ones.

I think hearings such as this give us an opportunity to take a look at it. It is one swing at bat; it is not all three swings at the bat; but at least it is better than nothing.

We will make this a part of the record, and hopefully, we will be able to follow up with further hearings on this subject.

I thank you again for coming. The committee stands adjourned.

[Whereupon, at 11:50 a.m., the committee adjourned, subject to the call of the Chair.]

[The following information was subsequently supplied for the record by the Council for a Competitive Economy:]

Why Not Abolish Antitrust?

Fred L. Smith, Jr.

DEREGULATORS APPEAR to be of two minds about antitrust. They denounce the actual practice of its enforcement. Yet, almost without exception, they endorse it in principle. Most want to continue to ban "excessive" horizontal mergers, price fixing, and other "anti-competitive" business practices. And most want to extend antitrust regulation to sectors of the economy that have heretofore been partially exempt, such as trucking, shipping, and airlines.

In other areas of regulation, economists have discovered that the market is far more robust in protecting consumer welfare than was once thought and that, conversely, government is highly prone to failings once thought reserved for the market (along with having some special failings of its own). Thus economic reformers have not only criticized the administration of regulatory statutes, but called for deregulation. But although they want to get rid of the Interstate Commerce Commission (ICC) and the Civil Aeronautics Board (CAB), they almost never apply the same analysis to the Federal Trade Commission (FTC) or the Antitrust Division of the Department of Justice. Antitrust may be the last refuge of the notion of "enlightened" regulation: it is thought of as a target for regulatory reform, not deregulation.

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The continued scholarly support for antitrust in principle is all the more surprising because of the tremendous erosion in support for its particular applications. Many actions once banned by antitrust enforcers, and many others still banned, are now recognized as enhancing efficiency. "Big" is no longer invariably seen as "bad," and the notion that collusive arrangements occur every day in the business world has been discredited. Antitrust is beginning to receive the same type of empirical scrutiny that George Stigler, a recent Nobel Prize winner in economics, and others have applied to consumer regulation. Yet few perceive that these waves of revisionist thinking will manage to wash away the remaining pillars of antitrust theory.

My purpose here is not to explain this inconsistency, but to review the case against antitrust and to explain why the call for complete antitrust deregulation deserves more attention than it has received. Most of my illustrations will be taken from the one area, price fixing, where nearly all economists still believe antitrust should be retained.

ECONOMISTS' SUSPICION of the efforts of businessmen to restrain trade dates back at least as far as Adam Smith's oft-quoted comment: "People of the same trade seldom meet to-

gether, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices" (*The Wealth of Nations*). But Smith doubted both the efficacy and the morality of enacting any laws on the matter: "It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice." And then he concluded: "[T]hough the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary."

Smith's view—the view that prevailed through most of the nineteenth century—was that the dangerous sort of market power was the monopoly power that emerged from government-granted protection. Most economists, accordingly, were cool to the new idea of antitrust legislation at the time the Sherman Act passed; they did not come to endorse it with any enthusiasm until the second decade of this century, by which time the notion we all absorb from childhood—that business rapaciousness is curbed only by antitrust laws—had been popularized by the Muckrakers. And it was not until the 1960s that support for adventurist antitrust enforcement became widespread in the profession. Politically, antitrust was peaking around this time, too: in 1968 a White House task force on antitrust policy (the Neal task force) recommended laws to break up leading firms in concentrated industries, and the FTC and Department of Justice reached a zenith of enforcement activity.

That enthusiasm, however, was short-lived. Before long economic scholarship began to reveal that all sorts of antitrust policies once applauded by economists were harmful to consumer welfare. Now the critics range, among economists, from Lester Thurow on the left ("The costs [antitrust] imposes far exceed any benefits it brings," *The Zero-Sum Society*) to Milton Friedman on the right ("I am inclined to urge that the least of the evils is private, unregulated monopoly . . . ," *Capitalism and Freedom*). The leading critics in recent years have been members of the Chicago School—in particular, Yale Brozen, Richard Posner, Harold Demsetz, and Robert Bork. Bork's conclusions in *The Antitrust Paradox* are reasonably representative:

> [M]odern antitrust has so decayed that the policy is no longer intellectually respectable. Some of it is not respectable as law; more of it is not respectable as economics; and . . . a great deal of antitrust is not even respectable as politics.

Bork presents cogent justifications for a whole range of practices questioned by conventional antitrust theory: small horizontal mergers, all vertical and conglomerate mergers, vertical price maintenance and market division agreements, tying arrangements, exclusive dealings and requirements contracts, "predatory" price cutting and price "discrimination." He would also ignore firm size if it came about through internal growth or acceptable mergers. Moreover, he defends agreements between competitors on prices, territories, refusals to deal, and other "suppressions of rivalry" that are "ancillary" to some economic efficiency. All of these practices, Bork finds, can enhance the competitive process and have foolishly been discouraged by antitrust regulation in the past. Since it is only lately that these bastions of orthodoxy have fallen, one might expect experts to maintain a seemly humility in the case of the few remaining policies that have not yet been—but may in the future be—discredited. After all, a full repudiation of the antitrust concept itself would represent only a moderate change compared to the shifts in intellectual opinion that have already occurred.

Since it is only lately that these bastions of orthodoxy [on antitrust policy] have fallen, one might expect experts to maintain a seemly humility in the case of the few remaining policies that have not yet been—but may in the future be—discredited.

Yet Bork wishes not to abolish antitrust, but only to reform it so that it "advances rather than retards competition and consumer welfare." He would still ban horizontal mergers that are "too" large and arrangements to fix prices or divide markets that do not contribute to efficiency. Similarly, Richard Posner and George Stigler advised the incoming Reagan administration to "throttle back" on antitrust,

but to retain the "healthy core of federal antitrust policy . . . the prohibition of horizontal price fixing (collusion) and large horizontal mergers." These core policies, they said, enjoy the support of "a consensus of economists of all political persuasions." Stigler's views come especially oddly from an economist who once pointed out that most economic reforms go wrong because "we don't know how to get there" (*The Citizen and the State*), who is noted for looking at the results of regulation—not its intent—and who has observed that "regulation and competition are rhetorical friends and deadly enemies" (*Can Government Protect the Consumer?*).

The Case against Antitrust

The full case against antitrust can only be sketched in a brief essay. It has at least five versions. In reverse order of their general acceptance, they are: (1) the libertarian view that the right to fix prices is part of a general and inviolable right to dispose of one's property as one sees fit; (2) the Austrian view that the neoclassical economic rationale for antitrust, based on the equilibrium perfect-competition model, is flawed; (3) the historical argument that efforts to fix prices have in practice generally been futile and are always likely to prove so; (4) the view of some neoclassical economists that price agreements help coordinate the plans of buyers and sellers (that is, provide offsetting efficiency gains); and (5) the public choice argument that antitrust, like other forms of regulation, gives private parties a way to cripple their competition through political influence, rather than market superiority.

Individuals Have the Right to Use Their Property as They Wish. Liberty is a neglected aspect of antitrust discussion. Why should a businessman not be free to restrain his own trade if he wishes, alone or in combination with others? The activities prohibited under antitrust laws are invariably *peaceable* activities—whatever their merit under an efficiency standard—and thus should be allowed in a free society. In Adam Smith's view, and in the view of many others, an individual rights or justice standard is at least as compelling as an efficiency standard in judging policy.

Bork, too, notes that "when no affirmative case for intervention is shown, the general preference for freedom should bar legal coercion" (*The Antitrust Paradox*). Still, in general, the

The activities prohibited under antitrust laws are invariably peaceable activities —whatever their merit under an efficiency standard—and thus should be allowed in a free society.

Chicago School's case for antitrust policy—and its opposition to price fixing in particular —rests solely on economic efficiency, as if rights had nothing to do with the matter—as if business had no right in principle to dispose of its property as it sees fit, but only a conditional freedom so long as it helps maximize some social utility function. That is to say, no business is entitled to its property if that property can be redeployed so as to expand output. With "conservative," "pro-business" economists taking this view, who needs social democrats?

Antitrust threatens basic rights in other ways, too, because of the unavoidable ambiguities and uncertainties in determining what behavior is efficient. These uncertainties lead to government arbitrariness and favoritism in enforcement, as well as a breakdown of the predictability that is necessary if citizens are to know when they are acting legally.

The Flawed Theoretical Basis of Antitrust. Antitrust was treated most skeptically by the illustrious economist Joseph Schumpeter, who saw the market not as some efficient state of static equilibrium, but as a dynamic process of "creative destruction." Schumpeter pointed out the artificial nature of the conventional neoclassical model of "perfect competition," in which markets are open, firms tiny, products homogeneous, buyers and sellers gifted with full information. Such a perfect world is always in equilibrium, and price equals marginal cost which in turn equals average cost. If any firm raises its prices above the market level, its sales disappear entirely. Otherwise the market is not perfectly competitive, and the firm is said to have "monopoly power," which reduces output and consumer welfare.

Whatever the educational value of this equilibrium model, it does not describe the processes by which equilibrium is approached. These processes are, indeed, the characteristic activities and features of real competition: product differentiation, price competition, advertising and other sales techniques, variation in the size and profitability of firms, technological innovation, and aggressive efforts to increase market share. When these elements of the competitive process do show up, the logic of the "perfect competition" model identifies them as "elements of monopoly."

In a true competitive economy, all firms have some degree of "control" over their prices and all seek to maximize profits by restricting output to some degree. But any "profit" that may result should be viewed, not as social waste, but rather as the dynamic incentive needed to move the economy toward more efficient production technologies and a closer match to consumer preferences. As Schumpeter explains in *Monopolistic Practices:*

> [E]nterprise would, in most cases, be impossible if it were not known from the outset that exceptionally favorable situations are likely to arise which exploited by price, quality and quantity manipulations will produce profits adequate to tide over exceptionally unfavorable situations provided these are similarly managed. Again, this requires strategy that, in the short run, is often restrictive. In the majority of successful cases, this strategy just manages to serve its purpose. In some cases, however, it is so successful as to yield profits far above what is necessary in order to induce the corresponding investment. These cases then provide the baits that lure capital on untried trails.

Thus a finding that prices exceed marginal cost may well indicate only that the market is not in equilibrium—and in most sectors we would be very surprised if it were. In fact, these temporary high profit and restricted output levels increase competitiveness. As Schumpeter noted: "There is no more of a paradox in this than there is in saying that motorcars are traveling faster than they otherwise would *because* they are provided with brakes."

Although Schumpeter did not oppose all antitrust regulation, he wanted industry to have the flexibility to organize its own "advances" and "retreats":

> Rational as distinguished from vindictive regulation by public authority turns out to be an extremely delicate problem which not every government agency, particularly when in full cry against big business, can be trusted to solve.

Dominick T. Armentano has in *The Myths of Antitrust* and more recently in *Antitrust and Monopoly* elaborated on the Schumpeter tradition in a way that provides the basis for rejecting even the remnants of antitrust regulation still favored by the Chicago School.

Price Fixing Rarely Succeeds. In the competitive process, said Adam Smith,

> The real and effectual discipline which is exercised over a workman is not that of his corporation [guild], but that of his consumers. It is the fear of losing their employment which restrains his frauds and corrects his negligence.

As Armentano has shown, the historical record indicates that, unless the government enforces rate agreements or erects barriers to entry, price-fixing agreements are rarely effective—except where the government itself is the purchaser. Government seems to lack both the internal profit incentives and the external goad of competition to encourage efficient purchasing behavior.

A would-be price-fixer faces numerous and formidable theoretical difficulties: the availability of substitutes, product differentiation, changes in demand, supply, production technology and costs, the difficulty of policing the agreement, resale among buyers, and market power among buyers. And the major legal cases seem to indicate that price fixing is in fact rarely successful. Thus *Addyston Pipe* (1899), *Trenton Potteries* (1927), and the great electrical equipment conspiracy (1961) all resulted in convictions, but in each case the cartels did not in fact succeed in fixing prices. Armentano notes that the customers testified on behalf of the *Addyston* conspirators, and analysis of the price data by Almarin Phillips suggests that the prices the conspirators charged were reasonable.

In his new book, *Concentration, Mergers and Public Policy,* Yale Brozen cites evidence that the *Trenton Potteries* defendants also failed in their attempt to fix prices: "the prices offered by low bidders were not those fixed by

the cartel." Official cartel prices no more dictate what consumers pay than list price dictates what you pay for a car. Yet even Bork approvingly quotes *Addyston Pipe* and *Trenton Potteries* as well-founded applications of the antitrust rules against cartels: the "contributions [of the rule against price fixing] to consumer welfare over the decades have been enormous." This is mysterious: consumers are not damaged by ineffective cartels, and Bork cites no effective cartels.

An antitrust case against a New Jersey trucking rate bureau, recently analyzed by Bruce Allen of the University of Pennsylvania, illustrates some of these questions. The case, on the surface, would seem to support antitrust theory. The carriers in the rate bureau published official rates that averaged 10 to 20 percent higher than those of independent carriers. Whether they succeeded in wielding market power, however, is questionable. A number of important shippers were not among the "cartel's" customers, and some independent carriers heavily advertised their lower rates in a bid for market share. There are also several reasons why rate bureaus may provide better service and thus command a higher price: they may lower the information costs of small shippers or pay better attention to their shipments (which may be why some large shippers used the large independent carriers). Most crucial, perhaps, the official bureau prices may not have been the prices actually charged by the member carriers. Unfortunately, data were not available on what shippers actually paid or how much traffic was actually carried at the higher rates.

If there is little empirical evidence that price fixing harms consumers even in such suspicious circumstances, it is no wonder that it cannot be proved significant in ordinary business settings.

Price Coordination Enhances Efficiency. Why might restrictive arrangements serve efficiency goals? One reason is that they provide firms with information that allows them to plan their production and marketing more efficiently. Friedrich Hayek and Thomas Sowell, for their part, say that the market's most vital and misunderstood role is that of creating information. Price discussions are one way to reduce the costs of information exchange. Truckers often claim that mutual discussions and common tariffs facilitate some discounts, product quality differentiation, and new services by providing a universally understood basis for bargaining and informing competitors of the state of the market. Such information might be supplied to the industry in other ways, by outsiders such as trade associations, consulting firms, or the trade press. But the market may be trying to tell us that the firms in the industry are best equipped to develop this information. To bar them from doing so does not deprive them of the market information, but merely increases needlessly the cost of providing it.

Most economists have come to perceive important efficiency gains in many vertical price maintenance agreements, but in the case of horizontal agreements they credit gains only where the collaborators actually integrate their economic activities and achieve cost reductions (an exception is Richard Posner's testimony on railroad rate bureaus and economic efficiency before the ICC on July 16, 1980). Bork discusses a number of ways, long ignored by antitrust scholars, in which rate fixing that is "ancillary" to the integration of economic activity can lead to important economic gains. Thus he concedes that rate cartels may reduce the costs of obtaining market information; but "the possible savings seem minuscule compared to the certainty of output restrictions"—although, as we have already seen, cartels do not always reduce output. Since there is no way to know beforehand how much the coordination of information is worth, how can we be sure that the efficiencies will be trivial? Bork does not tell us.

Outside observers find it hard to verify that "efficiency" has or has not improved in any instance, and harder to quantify its extent. Bork admits that this is a very subjective and subtle area, but he is willing to condemn price fixing anyway because he believes its only significant efficiency advantages are associated with some integration of other economic activities. But the survival of cartel arrangements in some open markets for long periods, despite open entry, suggests they must be providing efficiencies to shippers important enough to justify the higher rates.

No one can be sure what business arrangements will efficiently serve consumers even ten minutes from now, let alone in the year 2135. Antitrust laws, in their static way, typically ban

activities for which officials and scholars have not yet discovered the rationale; markets are more dynamic than that. The Justice Department and FTC now say that their antitrust policy has changed, and that in future they will allow most efficiency-enhancing arrangements —except for those that encourage price fixing.

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Aside from the inherent difficulty of making the latter judgment, it must be noted that in the past trustbusters have seen price fixing almost everywhere, so that it is doubtful that they will allow many new arrangements.

Antitrust Encourages Business to Look to Government. As Bork and others have shown, antitrust has often protected inefficient producers. These producers invoke government help to squelch their low-cost competition—much as truckers file ICC complaints against rate discounters. From July 1976 to July 1977, private parties filed 1,600 antitrust suits in federal courts, while government filed only 78. Antitrust encourages firms to win their competitive fights by relying on Washington lawyers and lobbyists instead of engineers, scientists, and computer experts.

William Breit and Kenneth Elzinga, two commentators relatively sympathetic to antitrust, note nonetheless that it "affords inducements to customers to behave perversely in hopes of collecting greater damages." Part of the problem is that buyers "can view the antitrust laws as a type of insurance policy against 'poor purchasing' and will at the minimum reduce their precautionary purchasing efforts." Breit and Elzinga cite a 1951 case in which an Arkansas canner refused to accept a shipment of cans because of a minor dispute over freight pricing, and then sued the can maker for triple damages "for losses incurred partly because the canning company had no cans." (A lower court ruled for the plaintiff, but was reversed on appeal.) Since 1951, Breit and Elzinga add, it has become much harder for defendants to escape by citing this sort of "antitrust entrapment"—which further encourages customers to try to strike it rich in the treble-damage sweepstakes.

Changing the Law

Any effort to challenge antitrust in principle will have to move beyond the coalition politics of trucking and airline deregulation. Libertarians—who hold that the right to reach voluntary price agreements is part of companies' general right to economic freedom, not a special privilege—are perhaps the natural core of a coalition for antitrust deregulation. Liberals and populists, on the other hand, seem to have supported past deregulatory moves because they view price floors and entry restraints as "pro-business"—which they do not believe, at least at present, is true of antitrust. Even liberal reformers who are no fans of trustbusting want special measures to deal with big firms; though Galbraith, for example, says that bigness is here to stay, he favors federal chartering of large firms. Many populists also view antitrust as a tool to force industry into various sorts of "cooperative" arrangements with government, as by allowing mergers when firms make concessions on plant closings. It will take a big educational effort to convince liberals that business itself uses antitrust in an anticompetitive manner.

Getting rid of antitrust would also focus reformers' energies on the true enemy of competition and consumer welfare—state-created privileges. In his recent book, Brozen notes that those structuralists who once saw low concentration and a large number of firms in a market as the essence of competition have largely changed their views: "entry barriers are the appropriate arena for antitrust action. The most significant barriers are those administered by regulatory agencies and licensing authorities." Armentano carries the point further:

> The critics of American business are right to be concerned about the manifestation of political power in society, but they are wrong to argue that monopoly power is to be associated with product differentiation or with concentration and market share. Nader, Green, and others, despite

(*Continues on page 33*)

Why Not Abolish Antitrust?
(*Continued from page 28*)

> some promising early work, have continued to blur the essential differences between private persuasion and government coercion, between efficiency as a barrier to entry and pernicious legal barriers, between power and production, and between economic and political accountability. Large corporations in open markets—regardless of their size—must earn their market positions each day through voluntary exchange [*Antitrust and Monopoly*].

The stakes are high, as Bork points out:

> Antitrust goes to the heart of capitalist theology, and since the laws' fate will have much to do with the fate of that ideology, one may be forgiven for thinking the outcome of the debate is of more than legal interest.

The most immediate ramifications of that debate are the controversies over whether to extend antitrust to previously exempt industries that are being deregulated. The trucking industry by and large wants to retain its antitrust exemption—no doubt because it hopes that exemption will prevent competition. Since this industry now enjoys more political than intellectual support, it may be able to win continued antitrust immunity without mounting any intellectual case at all. This would be unfortunate; such a victory would be widely perceived as just another instance in which industry power prevailed over the interests of the consumer.

It would therefore be a step forward if the truckers and other industries facing antitrust assault came to see that they have a more principled case for their position. To accept antitrust liability as the natural corollary of deregulation would mean the effective reregulation of every firm's price (and, in some cases, its entry) decisions. So it is only natural for the industry to resist. Which means that when truckers, travel agents, or others ask for exemption from antitrust regulation, they are not necessarily itching to organize a cartel the moment the public's back is turned. They may simply and understandably be trying to avoid a burdensome, unfair, and unproductive layer of regulation. And they may just have been reading the economic literature of the past decade. ■